

# **Remoteness and the Limitation of Contractual Damages**

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Thesis presented in fulfilment of the requirements for the degree of  
Master of Law in the Faculty of Law at Stellenbosch University

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December 2016

## DECLARATION

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## ABSTRACT

This study explores remoteness of contractual damages in South African law. The manner in which South African contract law limits the extent of a plaintiff's recovery of damages caused by breach is controversial. Criticism has been expressed about, *inter alia*, the distinction between general and special damages, the convention requirement imposed for the recovery of special damages, and the approach of determining remoteness at the time of contracting and not of breach. It is expected that the current approach will be revised when the opportunity arises. In light of the debate around the current South African approach, and the need for its development, this study provides a detailed overview of the premise, purpose and operation of rules of remoteness.

The study commences with a historical overview of the early civil and common law approaches to remoteness and their subsequent development in France, Germany and England. Against that background, the development of the South African approach is discussed and the various sources relied upon by South African courts placed in context.

The study then considers three different theories of remoteness: the direct consequences theory, the adequate cause theory, and the foreseeability theory. The direct consequences theory is discussed in the context of English law. The discussion highlights the necessity for the remoteness inquiry to take account of the facts of a particular case. The adequate cause theory, in turn, is explored in the context of German law. The theory's development into a discretionary, policy-based approach to remoteness is discussed with reference to the adoption of the *Schutzzwecklehre*.

The foreseeability theory is explored in two contexts: its application in English law and under the model instruments. The overview of English law shows that a distinction between general and special damages is often unhelpful and even detrimental to the remoteness inquiry. The recent move in English law toward an agreement-centred approach to remoteness is also evaluated with reference to the South African convention principle. Finally, foreseeability as applied in the model instruments is evaluated. It is concluded that the flexible approach to the foreseeability theory seen

in the model instruments addresses many of the identified limitations of traditional foreseeability tests.

The study suggests that the remoteness inquiry should focus on a discovery of what parties could reasonably have taken into account when contracting. For this reason, it is recommended that remoteness be determined with reference to the time of contract conclusion; and that it should not depend upon the parties' intentions or agreement about liability for damages. Additionally, the study finds that the foreseeability inquiry cannot draw a rigid distinction between the *nature* and *extent* of a loss. Ultimately, it is suggested that a flexible approach to foreseeability would resolve many of the limitations of the current South African approach. Such an approach would align the remoteness inquiry to notions of fairness and economic efficiency, as well as the constitutional value of human dignity.

## OPSOMMING

Hierdie studie ondersoek die begrensing van kontraktuele skadevergoeding in die Suid-Afrikaanse reg. Die wyse waarop die Suid-Afrikaanse kontraktereg 'n eiser se reg tot vergoeding vir skade veroorsaak deur kontrakbreuk beperk, is kontroversieël. Kritiek word uitgespreek teen, onder andere, die onderskeid tussen algemene en besondere skadevergoeding, die sogenaamde konvensie-vereiste vir die verhaalbaarheid van besondere skade, asook die feit dat aanspreeklikheidsbegrensing bepaal word met verwysing na die oomblik van kontraksluiting eerder as kontrakbreuk. Daar word verwag dat die huidige posisie hersien sal word wanneer die geleentheid hom voordoen. In die lig van die debat rondom die huidige Suid-Afrikaanse benadering, en die behoefte aan die ontwikkeling van daardie benadering, bied hierdie werkstuk 'n gedetailleerde oorsig van die vertrekpunt, doel en werking van reëls van aanspreeklikheidsbegrensing in die kontraktereg.

Die studie begin met 'n geskiedkundige oorsig oor die vroeë siviel- en gemeenregtelike reëls van aanspreeklikheidsbegrensing en die daaropvolgende ontwikkeling van hierdie reëls in Frankryk, Engeland en Duitsland. Teen dié agtergrond word die ontwikkeling van die Suid-Afrikaanse benadering uiteengesit, en die verskillende bronne waarop Suid-Afrikaanse howe gesteun het in daardie ontwikkeling in konteks geplaas.

Die studie oorweeg daarna drie verskillende teorieë oor die begrensing van kontraktuele skadevergoeding: die direkte gevolge-teorie, die adekwate veroorsakingsteorie, en die voorsienbaarheidsteorie. Die direkte gevolge-teorie word in die konteks van Engelse reg bespreek. Die bespreking van die teorie beklemtoon die noodsaaklikheid vir enige toets van aanspreeklikheidsbegrensing om die feite van elke spesifieke saak in ag te kan neem. Die adekwate veroorsakingsteorie word bespreek in die konteks van Duitse reg. Die teorie se ontwikkeling na 'n meer beleid-georiënteerde, diskresionêre benadering word bespreek veral met verwysing na die aanvaarding van die *Schutzzwecklehre*.

Die voorsienbaarheidsteorie word in twee verskillende kontekste ondersoek, naamlik Engelse reg en die model-instrumente. Die oorsig oor Engelse reg dui daarop dat 'n onderskeid tussen algemene en besondere skadevergoeding onnodig en selfs nadelig vir die bepaling van aanspreeklikheidsbegrensing is. Die onlangse beweging in Engelse reg na 'n ooreenkoms-gefokusde toets word geëvalueer met die oog op die Suid-Afrikaanse konvensie-vereiste. Die voorsienbaarheidstoets soos toegepas deur model-instrumente word laastens ondersoek. Daar word gevind dat 'n buigsame benadering tot die voorsienbaarheidsteorie in staat is om heelwat van die beperkings van die tradisionele toets, soos geïdentifiseer in die navorsing, te vermy.

Die studie kom tot die gevolgtrekking dat die aanspreeklikheidsbegrensing-ondersoek behoort te fokus op watter gevolge van kontrakbreuk partye redelikerwys tydens kontraksluiting in ag kon neem. Gevolglik word aanbeveel dat die beperking van kontraktuele skadevergoeding moet plaasvind met verwysing na die oomblik van kontraksluiting eerder as kontrakbreuk, en dat partye se ooreenkoms oor aanspreeklikheid nie die fokus van die toets behoort te wees nie. Daar word ook bevind dat daar geen streng onderskeid tussen die tipe en omvang van skade getref kan word nie. Uiteindelik word daar voorgestel dat die voorsienbaarheidstoets op 'n buigsame manier in Suid Afrika toegepas moet word. So 'n benadering is in lyn met oorwegings van ekonomiese doeltreffendheid en regverdigheid, asook die grondwetlike waarde van menswaardigheid.

## ACKNOWLEDGEMENTS

I would like to express my sincere gratitude and appreciation towards my supervisors, Professor Jacques du Plessis and Doctor Franziska Myburgh. The thorough and dedicated manner in which they guided me through this study has introduced me to the art of research and academic writing and has shaped my approach to legal studies. I am indebted to them for the wealth of wisdom that they were willing to share with me through their time, effort, and patience.

Secondly, I am humbled by the privilege of looking back on eight years of studies at the University of Stellenbosch which would never have been possible without the financial support that I received. I want to express my gratitude to all who made my undergraduate studies possible: the ATKV, the Dippenaar Trust, the Hanneli Rupert Getuienenistrust, Stellenbosch University's student loans and bursaries office, and my family who always contributed everything within their means to my studies. This postgraduate research in particular would never have been possible without the financial support of the University of Stellenbosch Law Faculty, the Dean's Fund, and the GA Kuhn Testamentary Trust. Especially in South Africa, I am conscious of the immense privilege and honour it is to have had this financial support on my academic journey.

I also want to extend my thanks to the Law Faculty of Stellenbosch, in particular Professors Sonja Human and Annika Rudman, for the mentorship that they offered during my years as a student there, and for the ways in which my years at the faculty has shaped me into the person I am today.

Finally, I want to thank my family for their unconditional support and understanding, and my friends who recognised my ability to complete this study even when I did not. Most importantly, I want to thank my best friend and greatest love, Phillip, for being my constant companion, source of strength, and inspiration.

**LIST OF ABBREVIATIONS**

<i>Am J Comp L</i>	<i>American Journal of Comparative Law</i>
<i>Cal L Rev</i>	<i>California Law Review</i>
<i>Cambridge L J</i>	<i>Cambridge Law Journal</i>
CESL	Common European Sales Law
CISG	The United Nations Convention on Contracts for the International Sale of Goods
<i>Columbia L Rev</i>	<i>Columbia Law Review</i>
DFCR	Draft Common Frame of Reference
<i>Edin L Rev</i>	<i>Edinburgh Law Review</i>
<i>E R P L</i>	<i>European Review of Private Law</i>
<i>Geo J Int'l L</i>	<i>Georgetown Journal of International Law</i>
<i>Geo Wash J Int'l L &amp; Econ</i>	<i>George Washington Journal of International Law and Economics</i>
<i>Hanse L R</i>	<i>Hanse Law Review</i>
<i>Harv L Rev</i>	<i>Harvard Law Review</i>
<i>J Leg Stud</i>	<i>Journal of Legal Studies</i>
<i>J L Econ &amp; Org</i>	<i>The Journal of Law, Economics and Organization</i>
JCL	<i>Journal of Contract Law</i>
<i>Law &amp; Contemp Probs</i>	<i>Law and Contemporary Problems</i>
LAWSA	<i>Law of South Africa</i>
LQR	<i>Law Quarterly Review</i>



<i>LS</i>	<i>Legal Studies</i>
<i>MLR</i>	<i>Modern Law Review</i>
<i>NJW-RR</i>	<i>Neue Juristische Wochenschrift – Rechtsprechungs-Report Zivilrecht</i>
<i>NWJ</i>	<i>Neue Juristische Wochenschrift</i>
<i>Pace Int'l L Rev</i>	<i>Pace International Law Review</i>
<i>PECL</i>	Principles of European Contract Law
<i>PICC</i>	UNIDROIT Principles of International Commercial Contracts
<i>SALJ</i>	<i>South African Law Journal</i>
<i>THRHR</i>	<i>Tydskrif vir die Hedendaagse Romeins-Hollandse Reg</i>
<i>U Chi L Rev.</i>	<i>University of Chicago Law Review</i>
<i>U W Ontario L Rev</i>	<i>University of Western Ontario Law Review</i>
<i>UCLJLJ</i>	<i>UCL Journal of Law and Jurisprudence</i>
<i>ULFS</i>	Uniform Law on the Formation of Contracts for the International Sale of Goods
<i>ULIS</i>	Uniform Law on the International Sale of Goods
<i>UNIDROIT</i>	International Institute for the Unification of Private Law
<i>University of Pennsylvania L R</i>	<i>University of Pennsylvania Law Review</i>
<i>Va L Rev</i>	<i>Virginia Law Review</i>
<i>Yale L J</i>	<i>Yale Law Journal</i>



## TABLE OF CONTENTS

DECLARATION.....	i
ABSTRACT.....	ii
OPSOMMING.....	iv
ACKNOWLEDGEMENTS.....	vi
LIST OF ABBREVIATIONS.....	vii
TABLE OF CONTENTS.....	x
 CHAPTER 1: INTRODUCTION.....	 1
1 1 Problem identification.....	1
1 2 Research purpose, overview and methodology.....	6
 CHAPTER 2: HISTORICAL AND COMPARATIVE OVERVIEW.....	 9
2 1 Introduction.....	9
2 2 Roman law.....	10
2 3 Later civil law.....	15
2 3 1 The French jurists.....	15
2 3 2 The Roman-Dutch jurists.....	18
2 3 3 Modern civil law.....	21
2 3 3 1 <i>French law</i> .....	21
2 3 3 1 1 <i>Direct consequences</i> .....	21
2 3 3 1 2 <i>Foreseeability</i> .....	23
2 3 3 2 <i>German law</i> .....	24
2 3 3 2 1 <i>The adequate cause theory</i> .....	24
2 3 3 2 2 <i>The Schutzzwecklehre</i> .....	25
2 4 English law.....	28
2 4 1 The development of the reasonable contemplation test.....	28
2 4 2 The assumption of responsibility test.....	32
2 5 South African law.....	34
2 5 1 Overview.....	34
2 5 2 Historical development.....	35
2 5 2 1 <i>Early contemplation tests and the development of a test for the recovery of general damages</i> .....	35

2 5 2 2	<i>The development of a test for the recovery of special damages..</i>	37
2 5 3	Criticism of the current position.....	40
2 6	<b>Conclusion.....</b>	<b>44</b>
<b>CHAPTER 3: THE DIRECT CONSEQUENCES THEORY.....</b>		<b>47</b>
3 1	<b>Introduction.....</b>	<b>47</b>
3 2	<b>The direct consequences theory in English law.....</b>	<b>49</b>
3 2 1	Introduction.....	49
3 2 2	Historical development.....	51
3 2 3	The direct consequences theory in the English law of contract.....	56
3 3	<b>The meaning of direct consequences in South African law.....</b>	<b>57</b>
3 3 1	The direct consequences theory.....	57
3 3 2	Other uses of the term “direct consequences”.....	59
3 4	<b>Evaluation.....</b>	<b>62</b>
3 5	<b>Conclusion.....</b>	<b>65</b>
<b>CHAPTER 4: THE ADEQUATE CAUSE THEORY.....</b>		<b>69</b>
4 1	<b>Introduction.....</b>	<b>69</b>
4 2	<b>The adequate cause theory.....</b>	<b>71</b>
4 2 1	Historical overview.....	72
4 2 1 1	<i>The theory of equivalent causation and the notion of conditions.</i>	72
4 2 1 2	<i>The development of the adequate cause theory.....</i>	<i>74</i>
4 2 2	The operation of the adequate cause theory.....	76
4 3	<b>The Schutzzwecklehre.....</b>	<b>81</b>
4 4	<b>Adequate cause and foreseeability.....</b>	<b>84</b>
4 4 1	Introduction.....	84
4 4 2	The meaning of a “normal course of events”.....	84
4 4 3	The relevant moment for determining liability.....	87
4 5	<b>Evaluation.....</b>	<b>88</b>
<b>CHAPTER 5: THE FORESEEABILITY THEORY: THE ENGLISH APPROACH... 93</b>		
5 1	<b>Introduction.....</b>	<b>93</b>
5 2	<b>The reasonable contemplation test.....</b>	<b>95</b>
5 2 1	The <i>Hadley</i> decision.....	95

5 2 2	Further developments in the application of the reasonable contemplation test.....	98
5 2 3	Criticism of the reasonable contemplation test.....	100
<b>5 3</b>	<b>The assumption of responsibility test.....</b>	<b>102</b>
5 3 1	The Achilleas decision.....	102
5 3 1 1	<i>The judgments of Lords Hoffmann and Hope.....</i>	103
5 3 1 2	<i>The judgments of Lady Hale and Lord Roger.....</i>	104
5 3 1 3	<i>The judgment of Lord Walker.....</i>	105
5 3 2	The operation of the assumption of responsibility test.....	106
5 3 3	Impact on the reasonable contemplation test.....	107
<b>5 4</b>	<b>The debate about an agreement-centred approach to remoteness of contractual damages.....</b>	<b>108</b>
5 4 1	The intentions of the parties as the basis of remoteness.....	108
5 4 2	The determination of the intentions of parties.....	110
5 4 3	Fairness.....	111
<b>5 5</b>	<b>Conclusion.....</b>	<b>112</b>
 <b>CHAPTER 6: THE FORESEEABILITY THEORY: THE MODEL INSTRUMENTS 119</b>		
<b>6 1</b>	<b>Introduction.....</b>	<b>119</b>
<b>6 2</b>	<b>Overview of remoteness in the model instruments.....</b>	<b>120</b>
6 2 1	The drafting of ULIS, ULFS and the CISG.....	120
6 2 1 1	<i>Historical background.....</i>	120
6 2 1 2	<i>The foreseeability provisions in ULIS and the CISG.....</i>	122
6 2 2	UNIDROIT PICC.....	125
6 2 3	PECL.....	126
6 2 4	Other instruments.....	127
6 2 5	Rationale for the foreseeability theory.....	129
<b>6 3</b>	<b>The operation of the foreseeability theory under the model instruments.....</b>	<b>130</b>
6 3 1	Correspondence with the foreseeability theory in English law.....	130
6 3 2	Application of the foreseeability theory.....	131
6 3 2 1	<i>The knowledge of the defendant.....</i>	131
6 3 2 2	<i>The extent of damage.....</i>	134
6 3 3	Flexible approach to the foreseeability theory.....	137

6 3 3 1	<i>Rationale for a flexible approach to foreseeability.....</i>	137
6 3 3 2	<i>Factors taken into account in the flexible approach.....</i>	138
6 3 3 3	<i>Effect on imputed knowledge.....</i>	142
6 4	<b>Conclusion.....</b>	<b>144</b>
<b>CHAPTER 7: CONCLUSION.....</b>		<b>147</b>
7 1	<b>Introduction.....</b>	<b>148</b>
7 2	<b>The most appropriate theory for determining remoteness: the foreseeability theory.....</b>	<b>148</b>
7 2 1	The underlying rationale for the limitation of contractual damages..	148
7 2 2	Economic efficiency.....	154
7 2 3	The Constitutional values informing the South African law of contract .....	156
7 3	<b>Conclusions about the application of the foreseeability theory...</b>	<b>158</b>
7 3 1	The distinction between different types of damages.....	158
7 3 2	The intentions of the parties.....	161
7 3 3	The distinction between the nature and extent of harm.....	165
7 3 4	Foreseeability from the perspective of the defendant alone.....	166
7 3 5	The level of probability with which harm has to be foreseeable.....	166
7 3 6	The flexible application of the foreseeability theory.....	168
7 3 6 1	<i>Rationale.....</i>	168
7 3 6 2	<i>Factors to be considered in the flexible foreseeability inquiry....</i>	171
7 4	<b>Conclusion.....</b>	<b>173</b>
<b>INDEX OF SOURCES.....</b>		<b>177</b>

## CHAPTER 1: INTRODUCTION

### 1 1 Problem identification

Damages for contractual breach can be defined as compensation to a plaintiff for the damage, loss or injury suffered as a result of that breach.<sup>1</sup> This compensation is awarded with the purpose of placing the plaintiff in the position he would have been in had proper performance taken place.<sup>2</sup> However, to avoid inequitable results, the law of contract places certain limits on the extent to which a defendant would be liable for such damages.

First, there must be a factual causal link or nexus between the defendant's breach and the loss suffered by the plaintiff as a result of that breach.<sup>3</sup> Secondly, the plaintiff is required to take all reasonable steps to mitigate the loss that he suffers, and failure to do so would render preventable losses non-recoverable.<sup>4</sup> However, these first two limits on contractual damages, which fulfil undeniably important functions in the South African law of contract, fall beyond the scope of this study. Here, the inquiry will focus on the third limit on contractual damages: remoteness.

In addition to factual causation and reasonable mitigation of losses by the plaintiff, contract law imposes a further limit on the recovery of losses caused by breach. This is that loss must not be too remote – or rather, that the breach must be the legal, and not merely the factual, cause of the loss suffered. The term legal causation is not

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<sup>1</sup> See HJ Erasmus & JJ Gauntlett "Damages" in WA Joubert, JA Ferris & LTC Harms (eds) *LAWSA* 7 2 ed (1995) paras 24-26; H McGregor, M Spencer, J Picton *McGregor on Damages* 18 ed (2009) 7.

<sup>2</sup> *Victoria Falls & Transvaal Power Co Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22; *Novick v Benjamin* 1972 2 SA 842 (A) 857F; *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* 2011 4 SA 276 (SCA) para 26; *Bellairs v Hodnett* 1978 1 SA 1109 (A); JC De Wet & AH van Wyk *Die Suid Afrikaanse Kontrakereg en Handelsreg I* 5 ed (1992) 224.

<sup>3</sup> *Combined Business Solutions CC v The Courier and Freight Group (Pty) Ltd* 2010 JDR 0826 (SCA) para 24; *Vision Projects (Pty) Ltd v Cooper Bell & Richards Inc* 1998 4 SA 1182 (SCA) 1191H; SWJ van der Merwe, LF van Huysteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 357.

<sup>4</sup> *De Pinto v Rensea Investments (Pty) Ltd* 1977 2 S 1000 (A); *Victoria Falls & Transvaal Power Co Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22; GF Lubbe & CM Murray *Farlam & Hathaway – Contract: Cases, Materials, Commentary* 3 ed (1988) 629; Van der Merwe et al *Contract* 365.

customarily used in the context of contract law, but it could describe this type of causal connection.<sup>5</sup> This limitation ensures that the defendant is held liable for harm caused by his breach only to the extent that it would be fair and reasonable to do so. In other words:

“In addition to the fact that a person can naturally not be liable to pay damages if damage did not actually flow from his or her breach of contract, it is likewise clear that he or she is not necessarily liable for all damage resulting from such breach.”<sup>6</sup>

In order to determine whether the loss suffered as a result of a breach of contract is too remote, the South African law of contract draws a distinction between general and special damages.<sup>7</sup> It is said that general damages can be considered to flow naturally and generally from a breach in the normal course of events<sup>8</sup> and is recoverable without a need to prove anything more.<sup>9</sup> This is because the law presumes that parties could reasonably have foreseen all natural consequences of breach of contract.<sup>10</sup> A plaintiff need only prove that the particular damage was of the kind that flows naturally and generally from the type of breach in question.<sup>11</sup>

When damages are not the kind that would have flowed naturally and generally from the breach in question they are considered special damages.<sup>12</sup> Such damages are in principle considered to have been unforeseeable, and parties will not be presumed to have contemplated it. A defendant will only be liable for special damages if two things can be proven. First, a plaintiff has to prove that there are special circumstances which make it reasonable to presume that the parties contemplated the damage as a

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<sup>5</sup> Van der Merwe et al *Contract* 366; JM Potgieter, L Steynberg & TB Floyd Visser & Potgieter – *Law of Damages* 3 ed (2012) 316.

<sup>6</sup> Potgieter et al *Law of Damages* 315.

<sup>7</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687B-687F; *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1962 2 SA 545 (A) 550B; *Lavery & Co v Jungheinrich* 1931 AD 156 162-163; Van der Merwe et al *Contract* 366; Lubbe & Murray *Contract* 626-267; Erasmus & Gauntlett "Damages" in *LAWSA* para 34.

<sup>8</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 580H; *Shatz Investment (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 550D.

<sup>9</sup> Van der Merwe et al *Contract* 367.

<sup>10</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687D.

<sup>11</sup> *BAT Rhodesia Ltd v Fawcett Security Organisation (Salisbury) Ltd* 1972 4 SA 103 (R) 104E.

<sup>12</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 550E; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687D-688A.



probable result of the breach of contract.<sup>13</sup> This is the *contemplation* requirement.<sup>14</sup> Secondly, it must also be proved that the parties entered into the contract with these special circumstances in view, or (under a more strict formulation of this requirement) that the parties had agreed, expressly or tacitly, that there would be liability for such damages.<sup>15</sup> This is the *convention* requirement.<sup>16</sup>

The South African approach to remoteness in contract is controversial.<sup>17</sup> In *Shatz Investments (Pty) Ltd v Kalovyrrnas*,<sup>18</sup> the Supreme Court of Appeal stated, with reference to the primary source of the current approach to special damages, *Lavery & Co v Jungheinrich* ("*Lavery*"),<sup>19</sup> that:

"[T]he principles enunciated in [*Lavery*]'s case ... are criticizable in certain respects. Perhaps the time is fast approaching when, in an appropriate case, the correctness of the principles stated there should be reconsidered."<sup>20</sup>

Authors and courts have raised doubts as to whether the current position resulted from a proper interpretation of the sources on which the courts relied.<sup>21</sup> In *Lavery*, the convention and contemplation requirements for the recovery of special damages were set out with reference to English case law<sup>22</sup> and the work of Pothier.<sup>23</sup> However, it has been stated by the Supreme Court of Appeal that

"neither the *Hadley v Baxendale* nor the *Victoria Falls Power* case, both of which were, *inter alia*, relied on in the judgment of [*Lavery*], insist on the convention principle; they

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<sup>13</sup> Van der Merwe et al *Contract* 369.

<sup>14</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 552B.

<sup>15</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 177.

<sup>16</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 552C, *Lazarus Bros v Davies & Kamann* 1922 OPD 88 91.

<sup>17</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687H; Lubbe & Murray *Contract* 624.

<sup>18</sup> 1976 2 SA 545 (A).

<sup>19</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156.

<sup>20</sup> 551A.

<sup>21</sup> GA Mulligan "Damages for Breach: Quantum, Remoteness and Causality IV: Special Damages in South African Law" (1956) 73 SALJ 27 38; *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 SA 553D; see the discussion in Ch 2 (2 5 3).

<sup>22</sup> *Hadley v Baxendale* [1854] 9 Ex 341. See *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 161, 168, 174.

<sup>23</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 164, 174-175.

postulate merely the contemplation principle. And the latter principle is apparently not ... the present English law."<sup>24</sup>

Courts have also interpreted Pothier in a way that is inconsistent with the convention principle.<sup>25</sup> This indicates that it may be worthwhile to undertake a thorough overview of the civilian and common law sources on which our approach to remoteness is based. In addition to the uncertainty about the appropriate interpretation of the sources that our courts have relied on, several points of criticism have also been raised against the operation of our approach to remoteness as it currently stands.

One of these points of criticism is directed at the distinction between general and special damages, which has been described as artificial and theoretically impure.<sup>26</sup> When determining whether or not damages are general, courts only refer to the content of the contract.<sup>27</sup> The concept of a normal course of events, or of the natural consequence of a breach, is therefore determined largely in a vacuum and without reference to the subjective positions and knowledge of parties. The result is that damages that are clearly foreseeable to parties will sometimes not be considered to be general.<sup>28</sup> The impact of this approach to general damages is exacerbated by the strict requirements set for the recoverability of special damages in the form of the convention requirement.<sup>29</sup> The result is that damages which parties clearly could have foreseen will not always be recoverable.<sup>30</sup> And to this can be added the related criticism that the convention requirement in any event relies on a fiction – parties often do not contemplate breach of contract at all, but rather its performance.<sup>31</sup> If contemplation of liability for special damages is highly unlikely, requiring agreement

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<sup>24</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 553A-553B.

<sup>25</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A) 553D-553F; Mulligan 1938 SALJ 38.

<sup>26</sup> JC De Wet & AH Van Wyk *Die Suid-Afrikaanse Kontrakereg en Handelsreg* I 5 ed (1992) 227. *Durban Picture Frame Co (Pty) Ltd v Jeena* 1976 1 SA 329 (D) 335-336 describes the approach as having "limited practical use".

<sup>27</sup> Van der Merwe et al *Contract* 370.

<sup>28</sup> 370.

<sup>29</sup> *Shatz Investment (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (A); *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A); *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* 2011 4 SA 276 (SCA) 291B-291D.

<sup>30</sup> Van der Merwe et al *Contract* 370.

<sup>31</sup> De Wet & Van Wyk *Kontrakereg en Handelsreg* I 227.

before special damages can be recovered does not seem fair or well-founded.<sup>32</sup> In other words, given the fact that the foreseeability inquiry usually involves supposing a contemplation process which "may not actually have been present to the mind of either party",<sup>33</sup> to insist on the convention requirement "seems merely to add unnecessarily to that criticizable artificiality."<sup>34</sup>

Another source of uncertainty and controversy in South African law is the level of likelihood with which damages must have been foreseeable in order to be recovered.<sup>35</sup> It has been stated that damages had to be foreseeable as a *likely* consequence of breach.<sup>36</sup> This was later changed to the requirement that damages had to be foreseeable as a *probable* consequence of breach.<sup>37</sup> This does not necessarily make the inquiry easier, however:

"It is not altogether clear whether the word 'probable' in the phrase 'which the law presumes the parties contemplated as a probable result of the breach' ... is to be understood in the sense of 'more likely to occur than not'."<sup>38</sup>

This warrants an exploration, in the context of different jurisdictions and theories of remoteness, of the challenges faced when delineating a particular level of likelihood within which damage must have been likely to occur.

Finally, criticism has also been raised against the recoverability of damages being determined with reference to the time of contract conclusion and not the time of breach.<sup>39</sup> Some authors argue that, because parties do not contemplate breach but performance at contract conclusion, there is no reason to determine the foreseeability of damage at the point of contracting.<sup>40</sup> The opposing argument, which has been

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<sup>32</sup> 227.

<sup>33</sup> *Bower v Sparks, Young and Farmers' Meat Industries Ltd* 1936 NPD 1 16.

<sup>34</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 SA 554E.

<sup>35</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 580G.

<sup>36</sup> *Victoria Falls and Transvaal Power Co Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

<sup>37</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA (A) 687D; *Lavery and Co Ltd v Jungheinrich* 1931 AD 156 169.

<sup>38</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) para 49.

<sup>39</sup> Van der Merwe et al *Contract* 370.

<sup>40</sup> 370.

accepted by the Supreme Court of Appeal,<sup>41</sup> is that the rights and duties of the parties are set at contract conclusion, and therefore the contemplation of the parties would have to be determined at that time.<sup>42</sup> The debate on the issue has not been resolved, however.<sup>43</sup>

South African courts have acknowledged the limitations of the current approach,<sup>44</sup> and have indicated that it "may be the subject of reconsideration on [an] appropriate occasion".<sup>45</sup> The uncertainty around the convention requirement, as well as the time at which foreseeability is determined, reveals a fundamental ambiguity about the underlying rationale for limiting contractual damages. It seems that there is uncertainty about whether liability for damages is determined with reference to the act of contracting, or the act of breach.<sup>46</sup> Additionally, there is disagreement about the premise underlying the remoteness inquiry. It is not clear whether liability is being limited based on parties' (presumed or actual) intentions, or rather on the consideration of reasonableness in the absence of any intentions.

## 1 2 Research purpose, overview and methodology

The purpose of this study is to address the problems identified above by examining various theories of remoteness with a view to identify the rationale underlying the remoteness inquiry. In the light of that rationale, different approaches to remoteness will be evaluated to gain insight into possible future developments of the South African law of contract in this regard.

The study commences with a historical and comparative overview of the development of rules of remoteness in the civil and common law. The various sources relied upon

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<sup>41</sup> *Shatz Investments (Pty) Ltd v Kalovyrmnas* 1976 2 SA 545 SA 551D-551H.

<sup>42</sup> AL Corbin *A Comprehensive Treatise on the Working Rules of Contract Law* 5 (1964)1007.

<sup>43</sup> See, for instance, *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 583C where the court suggests that the time of breach could be decisive.

<sup>44</sup> *Shatz Investments (Pty) Ltd v Kalovyrmnas* 1976 2 SA 545 (SCA) 554F; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 688A; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 581J and 582D.

<sup>45</sup> *Mia v Verimark Holdings (Pty) Ltd* 2009 JDR 0913 (SCA) 11.

<sup>46</sup> Van der Merwe et al *Contract* 370.

by South African courts are placed in context and a detailed overview of the current approach, as well as its limitations, will be provided.

This will be followed by an evaluative discussion of the three major theories of remoteness:<sup>47</sup> the direct consequences theory, the adequate cause theory, and the foreseeability theory. The first theory limits the recovery of loss to those losses that can be said to flow directly from a particular breach.<sup>48</sup> It has been most prominently employed in English law, and will be discussed in that context. The adequate cause theory in turn limits the recoverability of damages with reference to normative restrictions, such as community standards of justice and fairness.<sup>49</sup> This theory will be discussed in the context of German law. In terms of the third approach, the foreseeability theory, liability for damages is limited to those losses that can be reasonably supposed to have been in the contemplation of the parties as a probable result of the breach of contract. The application of the foreseeability theory will be explored in three different contexts: English law, the model instruments, and South African law.

In particular, each of the different theories of remoteness and their application in different jurisdictions will be evaluated to answer five questions: (i) why do we limit liability for contractual damages?; (ii) should there be a distinction between general and special damages?; (iii) should the recoverability of losses caused by breach be determined with reference to the parties' intentions?; (iv) is it possible to define a level of likelihood with which damages had to have been foreseeable, and if so, how should that be defined?; (v) should damages be limited with reference to the moment of contract conclusion, or the moment of breach?

This research will aim to place the South African approach in context, and provide insight into its possible future development, through a comparative study of how remoteness in contract is approached by different theories and across different jurisdictions. In light of the findings of the study, it will be argued<sup>50</sup> that the foreseeability theory is most suited for the South African law of contract. Its alignment

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<sup>47</sup> Erasmus & Gauntlett "Damages" in *LAWSA* paras 24-25; Lubbe & Murray *Contract* 624.

<sup>48</sup> De Wet & Van Wyk *Kontraktereg en Handelsreg I* 206.

<sup>49</sup> Lubbe & Murray *Contract* 624.

<sup>50</sup> Ch 7.

with the underlying rationale for limiting contractual damages makes it an economically efficient approach; and it gives effect to the constitutional value of human dignity.<sup>51</sup> It is suggested, however, that the theory should be approached in a much more flexible manner, and that the distinction between general and special damages, as well as the convention requirement, should be abandoned.<sup>52</sup>

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<sup>51</sup> Ch 7 (7 2).

<sup>52</sup> Ch 7 (7 3).

## CHAPTER 2: HISTORICAL AND COMPARATIVE OVERVIEW

### 2 1 Introduction

A study of the rules of remoteness of contractual damages can greatly benefit from an investigation of the rationale underlying those rules. The question of which limits should be placed on contractual damages, and how that should be done, have traditionally elicited controversial answers in South African law.<sup>1</sup> The point of departure for this research will therefore be an overview of the origins and development of the normative justifications for the limitation of contractual damages.

The South African law of damages consists of elements of both civil and common law.<sup>2</sup> Courts have turned to civil law when explaining the limitation of contractual damages in South African law – specifically with reference to the works of Voet, Domat and Pothier.<sup>3</sup> However, it has also been stated that the South African law on remoteness in contract is substantially the same as that of England.<sup>4</sup> Understanding the hybrid nature of our law of damages is especially necessary because the relative importance of the civil and common-law influences have varied over time.<sup>5</sup> This chapter will therefore aim to provide a concise overview of civilian and common-law influences on the current South African approach to remoteness in contract.

Section two considers the different measures used to limit liability for damages in Roman law. As we will see, classical Roman jurists formulated several provisions dealing with limitations on contractual damages in particular circumstances. The rules were not very clear, and there is no general underlying principle that can be identified. Section three explores how these rules were subsequently interpreted and introduced into the modern civilian legal tradition. This section will show how French jurists developed the foreseeability approach, and how that came to underlie the modern

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<sup>1</sup> GF Lubbe & CM Murray *Farlam & Hathaway – Contract: Cases, Materials and Commentary* 3 ed (1988) 624.

<sup>2</sup> JM Potgieter, L Steynberg & TB Floyd *Visser & Potgieter – Law of Damages* 3 ed (2012) 9.

<sup>3</sup> HJ Erasmus “Aspects of the History of the South African Law of Damages” (1975) 38 *THRHR* 104 105.

<sup>4</sup> *Victoria Falls & Transvaal Power Co Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

<sup>5</sup> HJ Erasmus & JJ Gauntlett “Damages” in WA Joubert, JA Farris & LTC Harms (eds) *LAWSA* 7 2 ed (1995) para 2.

French approach to the issue. The work of the Roman-Dutch writers will be discussed, and it will be seen that their work closely resembles the classical Roman law provisions – often with the same interpretative difficulties. Finally, the modern German approach will be discussed.

This is followed by an outline of the historical development and current approach used in English law. As arguably the principal source of the South African approach to remoteness of contractual damages, the development of English law is discussed in detail and with reference to a few landmark decisions. Finally, section five examines the influence of the civilian and common-law authorities discussed in the previous sections on the South African approach to this issue. This section aims to put the different sources relied upon by South African courts in context, and to provide an overview of the current approach as well as its limitations.

## **2 2 Roman Law**

Damages as it was understood in Roman law should not be equated with the remedy that we know today.<sup>6</sup> The principle of *omnis condemnatio pecuniaria* required all judgments to sound in money.<sup>7</sup> In the case of breach of contract, the right to claim damages was therefore not understood as one of several remedies available to the plaintiff. Rather, every action required a defendant to be condemned in a monetary amount.

In the case of actions for a specific thing (*actiones certae*) this amount would be objectively determined by the value of the object in question. For contracts of sale, this would be the value of the thing that was not delivered, for example. Damages were therefore not awarded based on the actual harm suffered by the plaintiff,<sup>8</sup> and were consequently not aimed at putting the plaintiff in the position he would have been in had there been proper delivery.

In the case of actions where the amount of damages could not be determined by ascertaining what the specific object was worth (*actiones incertae*), damages had to

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<sup>6</sup> R Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990) 824.

<sup>7</sup> 771-772.

<sup>8</sup> JE Sandys *A Companion to Latin Studies* 3 ed (1963) 326.



be determined with reference to the facts of each individual case.<sup>9</sup> In such cases the inquiry was therefore individualised with no objectively ascertainable limit to the amount of damages.<sup>10</sup> It was in this context that questions arose with regard to how liability for damages should be limited.

Although there was no general rule applicable to the limitation of liability for contractual damages in classical Roman law,<sup>11</sup> a number of jurists did discuss the topic in specific contexts.

One such instance involved cases where the non-delivery of a thing caused a buyer to suffer some sort of additional harm over and above the loss of the value of the thing itself. Paul used the example of a buyer who, because of the non-delivery of wine, could not sell that wine at a profit. A second example was where there had been non-delivery of grain, and the buyer's slaves died of starvation because of this. In such cases, Paul wrote that only losses that are "in close connection with this matter" would be recoverable:

"When the seller is responsible for non-delivery of an object, every benefit to the buyer is taken into account provided that it stands in close connection with this matter [*circa ipsam rem*]. If he could have completed a deal and made profit from wine, this should not be reckoned in, no more than if he buys wheat and his household suffers from starvation because it was not delivered; he receives the price of the grain, not the price of the slaves killed by starvation."<sup>12</sup>

The two cases mentioned here are examples where losses would not be recoverable. Profit that could potentially be made from selling the wine, or losses suffered because slaves died of starvation, are not in a sufficiently "close connection" with the matter. It is not apparent which losses would have been considered to be sufficiently closely connected, however. Moreover, it is also not apparent what Paul was referring to when he used the words "this matter". Whether or not the "matter" is the object of the obligation, or the breach thereof, is not clear.

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<sup>9</sup> 329.

<sup>10</sup> Zimmermann *The Law of Obligations* 826.

<sup>11</sup> HJ Erasmus "'n Regshistoriese Beskouing van Codex 7.47" (1968) 31 *THRHR* 213 217.

<sup>12</sup> D 19.1.21.3 as translated in A Watson *The Digest of Justinian 2* (1985) 94.

The term, *circa ipsam rem*, has also been translated as damage that “has reference to the property itself”.<sup>13</sup> Neither of the two translations make it clear which losses would be included as *circa ipsam rem*. Paul continued:

“An obligation does not increase because it is carried out slowly, although it would grow greater if wine were worth more today, and rightly so, for if the wine had been delivered, I as buyer would have it, and if not, that which should have been delivered previously is due now.”<sup>14</sup>

Perhaps an increase in the value of wine (possibly with reference to a market price) since the date of non-delivery could be regarded as damage that is *circa ipsam rem* and therefore sufficiently closely connected to “this matter”. That would imply an understanding of damage *circa ipsam rem* as losses sufficiently connected to the object of the obligation. This is not a very satisfactory explanation because this increase in the value would arguably also be the profit that a buyer would have been able to make from selling the wine later – and Paul expressly states that loss of profit is not recoverable. The rule and how it would function is unclear, and it does not necessarily assist us in defining which losses would have been included or excluded in damages in classical Roman law.

Another example that received some attention involved cases where there had been delivery of a defective *merx*. Pomponius wrote that where the seller had warranted that the *merx* would be in a certain state or of a certain capacity, and it turned out to be defective, the seller would be liable for loss of profits suffered by the buyer.<sup>15</sup> Ulpian also confirmed that where a seller knowingly delivered a defective *merx*, he would be liable not only for the reduction in the value of the performance received by the buyer, but also for losses caused by the defect. Labeo went even further. According to him a seller would be liable for all losses suffered by the buyer because of a defect in the *merx*, even in the absence of a warranty.<sup>16</sup> As an example he stated that where a

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<sup>13</sup> SP Scott *The Civil Law – Translated from the Original Latin* 5-6 (2001) 67.

<sup>14</sup> Watson *The Digest* 2 94.

<sup>15</sup> Scott *The Civil Law* 5-6 55.

<sup>16</sup> DJ Joubert “Lawyers, Arguments, Principles and Authority” in C Visser (ed) *Essays in Honour of Ellison Kahn* (1989) 173 174.

seller knowingly delivers a diseased cow, he would be liable for all the other animals that died as a consequence of being infected with the disease.<sup>17</sup>

The final instance that was specifically discussed was cases where someone leased a defective object. In this situation the extent of the lessor's liability appears to have been dependent on the type of *res* that was being leased. Ulpian wrote:

"If someone unknowingly leases out defective storage jars and wine runs out of them, he will be liable for the [lessee's] interest, nor will his lack of awareness be excused, so Cassius wrote as well. It is quite different if you leased out a pasture in which harmful weeds grew; in this case, if cattle either died or lost value, the [lessee's] interest is owing if you knew this, but if you were unaware of it, you may not sue for payment of rent, a view that Servius, Labeo and Sabinus also approved."<sup>18</sup>

The reason for this distinction is not clear, nor is it certain what exactly would be considered to fall under "the lessee's interest".

By Justinian's time, a single rule was formulated to deal with the limitation of contractual damages. This rule was adopted in reaction to the general uncertainty surrounding the issue of contractual damages that had existed at the time.<sup>19</sup> C 7.47.1 provided:

"[W]henever the amount or the nature of the property is certain, as in the cases of sales, leases and all other contracts, the damages shall not exceed double the value of the property. In all other instances, however, where the value of the property seems to be uncertain, the judges... shall carefully ascertain the actual amount of the loss, and damages to that amount shall be granted..."<sup>20</sup>

This rule has been described as arbitrary and mechanical.<sup>21</sup> Apart from the justification that "it is not in accordance with nature"<sup>22</sup> to impose penalties without limit, there was no principled justification for the rule. As we will see below,<sup>23</sup> this rule was later explained in terms of one underlying principle: foreseeability.

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<sup>17</sup> D19.1.13 pr as translated in Watson *The Digest* 2 90.

<sup>18</sup> D19.2.91.1 as translated in Watson *The Digest* 2 105.

<sup>19</sup> Scott *The Civil Law* 12-14 190.

<sup>20</sup> 190-191.

<sup>21</sup> Zimmermann *The Law of Obligations* 828.

<sup>22</sup> C7.47.1 as translated in Scott *The Civil Law* 12-14 191.

<sup>23</sup> Ch 2 (2 3 1).

In medieval law, there were several attempts to explain the different classical Roman law provisions dealing with the limitation of contractual damages. The text of Paul discussed above, which provides that, upon non-delivery, a buyer can only claim interests *circa ipsam rem* – in close connection with the matter<sup>24</sup> – became the basis for a distinction drawn by the glossators between *interesse circa rem* and *interesse extra rem*.<sup>25</sup> According to them, *interesse circa rem* referred to direct loss and *interesse extra rem* to consequential loss.<sup>26</sup> As will be seen later,<sup>27</sup> these distinctions were adopted in modern legal systems – although the terms came to convey different meanings in different jurisdictions.

Ulpian's text that imposed liability on a seller for losses caused by a defective *merx* if the seller had known about the defect became the basis of the notion that *interesse extra rem* should only be awarded in cases of fraud.<sup>28</sup> We shall see that this idea is still prominent in modern French law.<sup>29</sup>

Many writers also attempted to explain the distinction between cases where a lessor would be liable for defects in leased property and cases where he would not be liable. Accursius argued that a lessor would be liable for defects in leased wine containers, but not leased land, because defects in containers are easily detectable while this is not the case for a piece of land.<sup>30</sup> Bartolus did not agree that there would always be liability for a defect in containers. According to him liability had to be determined with reference to the specific contract.<sup>31</sup> This idea is also still prominent in modern law as we will see later.

We may briefly conclude this overview of the earlier civil law up to the time of the glossators with the general observation that the limitation of contractual damages in Roman law was unclear and seems to have been developed somewhat arbitrarily in

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<sup>24</sup> D 19.1.21.3 as translated in Watson *The Digest* 2 94; see above.

<sup>25</sup> Zimmermann *The Law of Obligations* 831.

<sup>26</sup> JW Wessels *The Law of Contract in South Africa II* (1937) 923, citing Molinaeus *Opera Omnia II Tractus de Contractibus et Usuris* 31 11.

<sup>27</sup> Ch 2 (2 3 3 1), (2 4), (2 5).

<sup>28</sup> Zimmermann *The Law of Obligations* 832.

<sup>29</sup> Ch 2 (2 3 3 1).

<sup>30</sup> Joubert "Lawyers, Arguments, Principles and Authorities" in *Essays in Honour of Ellison Kahn* 175.

<sup>31</sup> 175.

reference to specific situations. It did not attempt to explain the limitation of contractual damages in terms of an underlying principle. Nonetheless, the basic rules that we find in Roman law have been influential in the development of the modern approach to the issue. As will be seen below, the provision on “double damages” in C 47.7.1 formed the basis of the highly influential foreseeability-based approach to remoteness in contract that was developed by the French jurists in the sixteenth century. And Paul’s provision in D.19.1.21.3 and the glossators’ distinction between *interesse circa rem* and *interesse extra rem* in turn is reflected in works of the Roman-Dutch jurists and is still used in the South African law of contract.<sup>32</sup> To understand how the Roman law ideas about limitation of contractual damages were introduced into modern law, it is necessary to investigate how the French and Roman-Dutch jurists interpreted and developed these rules.

## 2 3 Later civil law

### 2 3 1 The French Jurists

The sixteenth-century French jurist Molinaeus was the first author to explain the C 47.7.1 double damages rule in terms of foreseeability.<sup>33</sup> He argued that the rule had an underlying rationale: it is equitable to limit damages to those harms or losses that could have been foreseen at the time when the contract was concluded. He argued that it can be presumed that parties could not have foreseen losses of more than double the value of the property. He added that where it is clear that parties actually did foresee the risk of damage in excess of the limit set by this rule, such damages would also be recoverable.<sup>34</sup> According to him, therefore, recoverable damages had to be limited with reference to what the defendant could be considered to have foreseen at contract conclusion. In cases where the defendant actually foresaw the risk of damage in excess of this limit, damages could be increased.

This principle – that liability for contractual damages is limited to losses that had been foreseeable – was adopted by the seventeenth and eighteenth century jurists Domat

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<sup>32</sup> Erasmus & Gauntlett “Damages” in *LAWSA* 7 para 17; *Whitfield v Phillips* 1957 3 SA 318 (A) 329.

<sup>33</sup> *Tractatus de eo quod interest* (Venetiis, 1574) 60 as quoted by Zimmermann *The Law of Obligations* 829.

<sup>34</sup> Erasmus 1975 *THRHR* 117.

and Pothier.<sup>35</sup> Pothier stated that a defendant would only be liable for loss or harm caused by breach which could have been contemplated at the time of contract conclusion – for he can only be presumed to have intended to submit to liability for losses that he could have foreseen.

As to which losses are deemed to have been contemplated at contract conclusion, he formulated the principle in a way that is similar to Paul's rule in D19.1.21.3. All damage and interest which would be suffered "in respect of the thing that is the object of the obligation" would be recoverable:

"In general parties are deemed to have contemplated only the damages and interest which the creditor might suffer from non-performance of the obligation, in respect of the particular thing which is the object of it, and not such as may have been incidentally occasioned thereby in respect to his other affairs: the debtor is not answerable for these, but only for such as are suffered with respect to the thing which is the object of the obligation..."<sup>36</sup>

As an example he used the case of a seller who failed to deliver a horse at the agreed time. In such a case the seller would be liable for any increase in the market price of horses that the buyer had to pay in order to obtain a horse of similar quality. He considered such damages to be intrinsic. According to Pothier, intrinsic damages ought to be recoverable because it related to the thing that is the object of the obligation (the horse) and because the particular damage – fluctuation in the market price of horses – could therefore have been foreseen.<sup>37</sup>

Using the same example, he stated that if the buyer had forfeited some revenue because he could not buy another horse in time to collect rent from tenants, such losses could not be claimed from the seller. Even though the losses were caused by the non-performance of the seller, Pothier considered it extrinsic and therefore in principle not recoverable:

"I should not be liable for the loss he sustained [because he could not collect rents]; although it was occasioned by the non-performance of my obligation; for this is a damage

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<sup>35</sup> Domat *Les Lois Civiles Dans Leur Ordre Naturel* 3 5, Pothier *Traité Des Obligations* as cited by Erasmus 1975 *THRHR* 118.

<sup>36</sup> WD Evans *RJ Pothier: A Treatise on the Law of Obligations or Contracts – Translated from the French* (1853) para 161.

<sup>37</sup> Para 161.

which is foreign to the obligation, which was not contemplated at the time of the contract, and to which it cannot be supposed that I had any intention to submit.”<sup>38</sup>

Pothier does not explicitly state why such losses “[were] not contemplated” at contract conclusion. The most plausible explanation might be that, exactly because extrinsic damages are foreign to the obligation, the seller was not necessarily able to foresee the damage. In other words – any losses directly related to the horse can be deemed to have been contemplated. But losses related to something that the buyer plans to do with the horse is not necessarily a type of loss that is reasonably foreseeable – that would depend on whether or not the seller knew what the horse was being bought for.

This seems in line with the rest of the text where Pothier states that extrinsic damages can be recovered in certain circumstances. Where it appears that extrinsic losses had been contemplated and that the defendant submitted to liability for those losses expressly or tacitly, he would also be liable for extrinsic damages.

“Sometimes the debtor is liable for damages and interest of the creditor, although extrinsic, which is the case when it appears that they were contemplated in the contract, and that the debtor submitted to them either expressly or tacitly, in the case of non-performance of his obligation...”<sup>39</sup>

The same example is used to explain that if there had been an express term in the contract stating that the horse must be delivered at a particular time so that the buyer may collect rents, and the buyer is unable to procure another horse and therefore forfeits the revenue, the seller would be liable for such damages. This would be because the loss was rendered foreseeable through the inclusion of an express term in the contract and the seller was therefore deemed to have taken that risk upon himself.<sup>40</sup> It seems therefore that Pothier based liability for intrinsic damages on deemed contemplation,<sup>41</sup> and liability for extrinsic damages on actual contemplation.<sup>42</sup>

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<sup>38</sup> Para 161.

<sup>39</sup> Para 162.

<sup>40</sup> Para 162.

<sup>41</sup> “In general, the parties are deemed to have contemplated only the damages and interest which the creditor might suffer from the non-performance of the obligation, in respect of the particular thing which is the object of it...” Para 161 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 181.

<sup>42</sup> “[T]he debtor is liable for damages and interests of the creditor, although extrinsic ... when it appears that they were contemplated in the contract, and that the debtor submitted to them either expressly or tacitly...” Para 162 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 182.

This is a distinction that became especially controversial in South African law, as will be seen later.

Finally, Pothier stated that in cases of fraud the defendant would be liable for unforeseeable damages as well. He relied on Ulpian's rule in D 1.19.1.13 pr. as authority for this statement.<sup>43</sup> When a defendant committed fraud, he would be liable for all losses or harms relating to the object of the contract itself, and those relating to any other property. Such damages would be imposed without considering whether the defendant can be presumed to have submitted to them.<sup>44</sup>

The rules set out by Pothier above had a direct impact on the modern French law of contract as well as on the English approach to the limitation of liability for damages as will be seen later in this chapter. Even though his use of foreseeability, or contemplation, as an underlying principle limiting liability for damages was not accepted by the Roman-Dutch writers, as we will presently see, it came to influence South African law.

### 2 3 2 The Roman-Dutch jurists

The Roman-Dutch jurists, like their predecessors, accepted that there had to be some limitation on liability for contractual damages.<sup>45</sup> Exactly how liability for damages should be limited seems to have been explained with reference to particular situations – an approach similar to that used in classical Roman law. Rather than the formulation of one over-arching principle in terms of which liability should be limited, different writers expressed their opinion on the matter with regards to particular contracts or circumstances.

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<sup>43</sup> J Gordley "Responsibility in Crime, Tort and Contract for the Unforeseeable Consequences of an Intentional Wrong: A Once and Future Rule?" in P Cane & J Stapleton (eds) *The Law of Obligations – Essays in Celebration of John Fleming* (1998) 176 202.

<sup>44</sup> Evans *Pothier: A Treatise on the Law of Obligations* para 166.

<sup>45</sup> Voet *Commentarius ad Pandectas* 19.1.20 as translated in P Gane *The Selective Voet: Being the Commentary on the Pandects by Johannes Voet (1647-1713) and the Supplement to that Work by Johannes van der Linden (1756-1835)* 5 (1956) Paris Edition of 1829 and the Supplement to that Work 6 (1959) 396.



Voet relied on D 19.1.21.3 to provide that loss of profits could not be claimed if it “is either too indefinite or too farfetched”.<sup>46</sup> As illustration for this rule he employed the same examples used by Paul to describe damage that would not be sufficiently closely connected to the object of the obligation in question. A buyer would not be able to claim for loss of profits because he could not sell the wine that the seller had failed to deliver. He would also not be able to claim for losses incurred because his household suffered hunger as a result of the seller’s failure to deliver wheat.

It is still not clear which losses would be recoverable under this rule. To add to the uncertainty, where Paul’s provision dealt only with non-delivery, the text by Voet does not limit the rule to non-delivery. What the rule would mean in cases where a defective *merx* was delivered is therefore somewhat unclear. Regardless, our courts have referred to this rule as set out by Voet when dealing with the limitation of contractual damages<sup>47</sup> as will be seen later.

In cases where losses were caused by a defect in the *merx*, other Roman-Dutch jurists also formulated rules based on the provisions discussed earlier in the overview of the position in Roman law. Where the seller had made certain *dicta et promissa* with regard to the goods being sold, he would still only be liable for the reduction in the purchase price or for restitution in terms of the *actio redhibitoria* and not for additional damage suffered by the buyer.<sup>48</sup> The exception was in cases where the seller acted in bad faith – then he would be liable for all losses suffered by the buyer.

With regards to contracts of lease, both Grotius<sup>49</sup> and Voet<sup>50</sup> held that a lessor would be liable for all losses caused by a defect in the leased property if he knew about the defect, or should have known because of his trade.

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<sup>46</sup> 45.1.9.

<sup>47</sup> *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

<sup>48</sup> Voet *Commentarius ad Pandectas* 21.1.3. as translated in Gane *The Selective Voet* 644.

<sup>49</sup> H De Groot *Inleidinge tot de Hollandsche Rechts-Geleerdheid I* 2 ed (1910) 3.19.12.

<sup>50</sup> Voet *Commentarius ad Pandectas* 19.2.14 as translated in Gane *The Selective Voet* 6 419.

Furthermore, various Roman-Dutch jurists also confirmed the rule as set by Justinian in C 47.7.1: in cases where the value of the thing was certain, damages could not exceed double that value.<sup>51</sup> Voet wrote that this rule “still holds good”.<sup>52</sup>

There seems to be no reference in Roman-Dutch law to the French jurists’ works that relate the limits on damages to what could have been contemplated and therefore (presumably) submitted to by the defendant. The most likely candidate, Van der Linden, refers to the work of Pothier – specifically sections 168 and 169 that deal with how damages must be defined. However, he does not make any mention of Pothier’s foreseeability-centred explanation of the limits on liability for damages.<sup>53</sup>

The rules dealing with limitation of damages in Roman-Dutch law seemed to have loosely followed those discussed in classical Roman law. The rules were set out in reference to specific situations and no attempt was made to reconcile them under one principle. Our courts have relied mostly on English law and on the works of the French jurists to deal with the limitation of contractual damages. Our courts do refer to Roman-Dutch and Roman authorities, however – often in attempts to reconcile the Roman-Dutch principles with those found in the work of Pothier.<sup>54</sup> As will be seen later, this is a potential source of the current confusion seen in our law of remoteness of contractual damages. Before turning to the primary source of our rules for limiting contractual damages – English law – a brief comparative overview of the approach followed in modern France and Germany will be provided.

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<sup>51</sup> Van der Linden *Rechtsgeleerd, Practicaal en Koopmans Handboek* 14.7 as translated in H Juta *Institutes of Holland or Manual of Law, Practice and Mercantile Law by Johannes van der Linden-Translated from the Original Dutch* 4 ed (1904) 110. He also refers to Voet, Groenewegen and Bynkershoek in support of this conclusion.

<sup>52</sup> Voet *Commentarius ad Pandectas* 45.1.10 as translated in Gane *The Selective Voet* 5 631.

<sup>53</sup> Van der Linden *Rechtsgeleerd, Practicaal en Koopmans Handboek* 14.7 as translated in Juta *Institutes of Holland by Johannes van der Linden* 110.

<sup>54</sup> *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

### 2 3 3 Modern civil law

#### 2 3 3 1 French Law

The limitation of liability for damages in modern French law closely follows the rules laid down by Pothier.<sup>55</sup> The *Code Civil* provides that:

"A debtor is held only to damages which were foreseen or which could have been foreseen at the time of the contract, when it is not by his wilfulness that the obligations were not executed. Even in the case where the inexecution of the agreement results from the wilfulness of the debtor, damages are to include ... only what is an immediate and direct consequence of the inexecution of the agreement."<sup>56</sup>

Therefore, liability for losses caused by breach of contract is limited to those losses that were the direct consequence of the breach. If the breach was not intentional, liability is further limited by the requirement that the loss should have been foreseeable by the defendant.

#### 2 3 3 1 1 Direct Consequences

The precise meaning of the requirement that the loss must be the direct consequence of a breach of contract and how one determines whether the loss is a sufficiently "direct" consequence is uncertain.<sup>57</sup> Reference is often made to Pothier's

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<sup>55</sup> Erasmus 1968 *THRHR* 235.

<sup>56</sup> *Code Civil des Français* 1150-1151 as translated in JH Crabb *The French Civil Code* revised edition (1995) 223. The French Civil Code is currently under revision and the proposed changes, contained in Ordinance N° 2016-131, are set to be adopted on 1 October 2016. The revision largely codifies judicial reforms. The new provisions on remoteness of damages, Articles 1231-3 and 1231-4, does not depart from Articles 1150-1151 discussed here. The provisions are: "A debtor is bound only to damages which were either foreseen or which could have been foreseen at the time of conclusion of the contract, except where non-performance was due to a gross or dishonest fault. In the situation where the non-performance of a contract does indeed result from gross or dishonest fault, damages include only that which is the immediate and direct result of non-performance." as translated in J Cartwright, B Fauvarque-Cosson & S Whittaker "The Law of Contract, the General Regime of Obligations and Proof of Obligations – The new Provisions of the *Code Civil* created by Ordinance n° 2016-131 of 10 February 2016 Translated into English" *Legifrance* < [http://www.textes.justice.gouv.fr/art\\_pix/THE-LAW-OF-CONTRACT-2-5-16.pdf](http://www.textes.justice.gouv.fr/art_pix/THE-LAW-OF-CONTRACT-2-5-16.pdf).> (accessed 05-09-2016).

<sup>57</sup> HG Beale, A Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Texts on Contract Law* 2 ed (2010) 1004; B Nicholas *The French Law of Contract* 2 ed (1992) 229.

explanation,<sup>58</sup> where he uses the example of a man who knowingly sells a cow with an infectious disease to a farmer. This causes the farmer's other animals to die, and as a result he cannot cultivate his land. Because of this he is unable to pay his debts and consequently his creditors seize his property.

Pothier held that the loss suffered because of the death of the cow and other animals is a direct consequence of the seller's intentional breach and can therefore be claimed. There is no clear explanation in the text as to why the deaths of the other animals are considered to be a direct consequence. It seems to be simply because there is a close causal connection between the breach and the damage: "it is a fraud of the seller which occasions the damage".<sup>59</sup>

To get a better idea of what is meant by direct consequences one has to refer to Pothier's explanation of how the other consequences of breach must be regarded. According to him, the loss of the farmer's land is an indirect consequence and has no 'necessary relation' to the breach. It is therefore not recoverable:

"[T]he seller will not be liable for the damage which I suffer from the seizure of my effects; this damage is only a very remote and indirect consequence of his fraud, and has not any necessary relation to it..."<sup>60</sup>

It seems therefore that something is considered a 'direct' consequence by Pothier and modern French law if there is a 'necessary relation' between the breach and the consequence in question. This does not make the inquiry easier. To explain the principle further, Pothier wrote that the loss suffered because land was not cultivated, although not a direct consequence of the breach, should also be compensated in part by the seller:

"The loss, which I suffer for want of cultivating my lands, appears to be a less remote consequence of the fraud of the seller [than the loss of land], nevertheless I think that he ought not to be liable for the whole of it. This want of culture is not an absolutely necessary consequence of the loss of my cattle: for, notwithstanding such loss, I might have obviated the want of cultivation by buying, or ... by hiring other cattle, or by farming out my lands;

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<sup>58</sup> Evans *Pothier: A Treatise on the Law of Obligations* para 166-167. Beale et al *Cases, Materials and Texts on Contract Law* 1004 indicates that it is quoted in Maularie & Aynès *Les Obligations* 9 ed (1998) 838; Nicholas *French Law of Contract* 229.

<sup>59</sup> Para 166 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 186.

<sup>60</sup> Para 167 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 187.

nevertheless... I should not derive so much profit by my land, as if I could have cultivated it myself, by cattle that were lost in consequence of the fraud: this therefore may in some degree be taken into account of the damages and interests for which he is liable.”<sup>61</sup>

This sounds like the rule limiting liability for damages based on the defendant’s duty to mitigate his losses that is also recognised in South African law.<sup>62</sup> Apart from this requirement that a defendant has to mitigate losses to the extent that would be reasonable, all consequences that are sufficiently direct – in other words, necessarily related to the breach in question – would be recoverable in cases where the breach was committed with intent. This is by no means a satisfactory explanation of the test for directness. It is however also not something that is often practically relevant in French law because most cases of breach of contract do not deal with intent.<sup>63</sup> In all cases that do not deal with intent, liability for damages would be limited to the loss that the defendant could have foreseen or actually did foresee at contract conclusion.

### **2 3 3 1 2 Foreseeability**

As we have seen, if a person did not breach a contract intentionally, the direct consequences of the breach will only give rise to liability for damages when they were or could have been foreseen.

This ‘foreseeability limit’ on liability was originally applied only to the *type* of loss recoverable. If a defendant could foresee a certain *type* or *kind* of harm as a consequence of his breach, he would be liable for it regardless of the foreseeability of the *extent* of the actual harm. However, the foreseeability limit has since been adapted to apply to the extent of loss as well.<sup>64</sup> This shift reflects the principle underlying the remoteness provisions – a party must have been reasonably able to know the extent of potential liability he was undertaking in terms of the contract in question.<sup>65</sup> In applying the test, the courts adopt an objective approach: they have to determine whether a reasonable man (*bon père de famille*) would have been able to foresee the

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<sup>61</sup> Para 167 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 187.

<sup>62</sup> SWJ Van der Merwe, LF Van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 366-367.

<sup>63</sup> Nicholas *French Law of Contract* 230.

<sup>64</sup> Beale et al *Cases, Materials and Texts on Contract Law* 1004.

<sup>65</sup> Nicholas *French Law of Contract* 231.

loss in question – it is irrelevant whether or not the defendant actually did foresee the loss.<sup>66</sup>

As we will see, this differs from the South African approach. Two differences can briefly be mentioned here. First, the French approach determines foreseeability only with reference to the defendant. In the South African approach foreseeability is determined with reference to both parties. Secondly, the French approach makes use of the term “direct consequences”, as is also seen in South African law, but the terms do not convey the same meaning. The differences between these two approaches can be especially enlightening because South African courts often refer to Pothier’s work on which the French *Code Civil* is based. These differences will be further explored in the section on South African law and in Chapter 3 when dealing with the direct consequences theory of remoteness.

## 2 3 3 2 German Law

### 2 3 3 2 1 The adequate cause theory

In German law, the primary test for the limitation of contractual damages is encompassed in the *Adäquanztheorie* – the adequate cause theory. This is one of the three theories that have been mentioned in our law as possible bases for the limitation of contractual damages.<sup>67</sup> A brief introductory overview of the content and functioning of the adequate cause theory in modern German law will be provided here as background for later discussion in Chapter 4.

Briefly summarised, the limitation of contractual damages in German law is determined with reference to a basic factual causation test, further refined by the adequate cause test.<sup>68</sup> The adequate cause test is summarised by the *Bundesgerichtshof* as follows: a condition is an adequate condition if it generally and appreciably enhanced the objective possibility that a consequence of the kind in

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<sup>66</sup> H Mazeaud, L Mazeaud & A Tunc *Traité théorique et pratique de la responsabilité civile délictuelle et contractuelle* III 6 ed (1965) paras 2381-2382 as cited by Nicolas *The French Law of Contract* 231.

<sup>67</sup> The others are the direct consequences theory and the foreseeability theory. See Lubbe & Murray *Contract – Cases, Materials and Commentary* 624.

<sup>68</sup> R Schulze & F Zoll *The Law of Obligations in Europe: A New Wave of Codifications* (2013) 210.

question would have occurred.<sup>69</sup> This is determined firstly with reference to the circumstances that an “optimal” observer at the time of the event would have recognised. Secondly, the court also takes cognisance of additional circumstances actually known to the defendant.<sup>70</sup>

### **2 3 3 2 2 The *Schutzzwecklehre***

Academic opinion<sup>71</sup> and increasingly also the German courts<sup>72</sup> favour the application of a further refinement of the adequate causation test, captured in the “protective purpose of the norm”<sup>73</sup> theory, or the *Schutzzwecklehre*. The *Bundesgerichtshof* has held that the theory of adequate causation only serves to eliminate the most unlikely of consequences and that it does not preclude an inquiry into the purpose of the contract to determine liability.<sup>74</sup> There are many examples of German courts applying this test alongside that of adequate causation.<sup>75</sup>

One such example can be found in the case of *OLG Köln, 8 July 1982*.<sup>76</sup> In this case a banker gave confidential information to the authorities about a number of false accounts held by the plaintiff. The plaintiff was consequently prosecuted and convicted for tax evasion and sought to claim damages from the bank employee because of his breach of the confidentiality clause in the banking agreement. Although the action of the bank employee was the adequate cause of the damage suffered by the plaintiff, the court held that the purpose of the contract with the bank was never to avoid such disclosures and therefore the banker was not liable for the damages.

The *Schutzzwecklehre* limits liability for damages to a greater extent than the adequate causation test. It therefore serves as an additional refinement of the test for

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<sup>69</sup> BGHZ 3, 261 as translated in BS Markesinis *A Comparative Introduction to the German Law of Torts* 3 ed (1994) 607-609.

<sup>70</sup> 609.

<sup>71</sup> BS Markesinis, H Unberath & A Johnston *The German Law of Contract: A Comparative Treatise* 2 ed (2006) 474.

<sup>72</sup> Hart & Honoré *Causation in the Law* 2 ed (1985) 476.

<sup>73</sup> Beale et al *Cases, Materials and Texts on Contract Law* 1004.

<sup>74</sup> BGH NJW 2001, 514 as quoted in Markesinis et al. *The German Law of Contract: A Comparative Treatise* 474.

<sup>75</sup> Markesinis et al *The German Law of Contract: A Comparative Treatise* 473.

<sup>76</sup> BB 1992, 2174 as discussed in Beale et al *Cases, Materials and Texts on Contract Law* 824.



the limitation of liability for damages.<sup>77</sup> The theory requires a court to determine whether or not the contractual provision that had been breached had the purpose of protecting the plaintiff from the type of harm that resulted from the breach.<sup>78</sup> It therefore involves a teleological interpretation of the breached contractual term.<sup>79</sup> The nature and extent of the protective purpose of the breached provision is determined by taking account of all circumstances, including the intentions of the parties. The test gives a judge considerable discretion.<sup>80</sup>

According to Zimmermann, the *Schutzzweck* theory is an example of the way in which German law was influenced by the contemplation principle as it was adopted in French and English law.<sup>81</sup> The *Schutzzweck* approach was first proposed by Ernst Rabel in 1932.<sup>82</sup> He formulated the approach with reference to the test for foreseeability as formulated by Pothier<sup>83</sup> and English case law on the matter.<sup>84</sup> He stated that the scope and the purpose of the contract should determine the consequences of breach. According to Rabel, determining the scope and purpose of a contract indicates which types of risks the defendant can be presumed to have accepted when contracting.<sup>85</sup>

Although the *Schutzzwecklehre* approaches the issue of limiting contractual damages from a different perspective than that of French law, it has the same underlying premise. This is the premise that damages should be limited with reference to what parties can reasonably be considered to have taken into account at contract conclusion. In the foreseeability approach, what parties could have taken into account is determined with reference to what could have been foreseen. In the *Schutzzweck* approach, this is determined with reference to the purpose of the contract.

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<sup>77</sup> Beale et al *Cases, Materials and Texts on Contract Law* 1014.

<sup>78</sup> P Schlechtriem & M Schmidt-Kessel *Schuldrecht: Allgemeiner Teil* 6 ed (2005) as quoted in Beale et al *Cases, Materials and Texts on Contract Law* 1010.

<sup>79</sup> R Young *English, French and German Comparative Law* (1988) 302.

<sup>80</sup> H Lange *Schadensersatz* (1979) 79 as cited in Beale et al *Cases, Materials and Texts on Contract Law* 1014.

<sup>81</sup> Zimmermann *The Law of Obligations* 830.

<sup>82</sup> E Rabel "Die Grundzüge des Rechts der unerlaubten Handlungen" (1932) *Deutsche Ref. Int. Kong. Rechtsvergl.* as cited in HLA Hart & T Honoré *Causation in the Law* 2 ed (1985) 476.

<sup>83</sup> E Rabel *Das Recht Des Warenkaufs – Eine Rechtsvergleichende Darstellung I* (1936) 492.

<sup>84</sup> 495.

<sup>85</sup> 495 para 8.



Stated more simply: in terms of the foreseeability approach that is used in French law, a court will determine what a defendant could be considered to have contemplated by examining whether the damage was reasonably foreseeable. If that is the case, such damage is deemed to have been in the contemplation of the defendant and he is presumed to have assumed liability for it.

In terms of the *Schutzzweck* approach, a court determines what parties could be considered to have contemplated with reference to the purpose and protective scope of a particular contractual provision. This is done by determining if the damage affects an interest that the contractual provision was aimed at protecting. If that is the case, such damage is deemed to have been contemplated, and the defendant is presumed to have assumed liability for it.<sup>86</sup>

The *Schutzzweck* theory remains, however, a subsidiary part of the inquiry into the limits of liability for damages in German law. Generally, it is regarded as a useful supplement to the adequate cause theory, but not as a replacement.<sup>87</sup> It has been argued that the theory is useful in cases where a violated provision has a clear and circumscribed purpose. In other cases, reliance on the purpose of a contractual provision is to entrust too much of the inquiry to the discretion of the judge.<sup>88</sup> German law's primary focus on adequate causation as a limit on liability in contract remains intact.

As will be seen later in this study, the German approach is relevant to the discussion of the South African law of contractual damages. This is because the adequate cause theory – and possibly further developments such as the *Schutzzweck* theory - has been suggested as an alternative to our current approach.<sup>89</sup> Further evaluation of the adequate cause theory and its implications for our current approach will be discussed in chapter four. Now, however, we turn to the jurisdiction which forms the primary basis of the South African approach: English law.

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<sup>86</sup> Von Caemmerer "Das Problem des Kausalzusammenhangs" in *Gesammelte Schriften II* (1956) 395, as cited in Markesinis *The German Law of Torts* 101.

<sup>87</sup> Hart and Honore *Causation in the Law* 477.

<sup>88</sup> 477.

<sup>89</sup> Lubbe & Murray *Contract* 624.

## 2 4 English law

### 2 4 1 The development of the reasonable expectations test

Early common law drew a distinction between two basic types of actions. These were the action of trespass on the one hand and the action of debt and detinue on the other hand. Actions of trespass were based on a wrong committed against a plaintiff, in terms of which he claimed damages. Here, the purpose of damages was to compensate the plaintiff for the loss he had suffered. Opposed to this, actions of debt were used in cases where a plaintiff wanted to claim something that he was entitled to. In such a case the compensation awarded to him was based on his entitlement, and not necessarily the loss that he suffered.<sup>90</sup>

By the fifteenth century this distinction had been developed more strongly. On the one hand, the action of trespass was used for all claims that were based on damage suffered. The action of debt was used for all claims based on entitlements demanded.

In the case of breach of contract, this distinction was reflected in the separation between actions based on non-performance of a contract and those based on defective performance. The former resorted under the action of debt, where the core focus was the plaintiff's entitlement. The latter resorted under the action of trespass, where the focus fell on damages that were actually suffered by the plaintiff. The action for trespass was part of the law of tort and the action of debt was part of the law of contract.

The result was that, when there was non-performance of a contract, this would be addressed within the framework of the law of contract – by the action of debt. When there had been defective performance, it would be addressed within the law of tort – with an action of trespass.<sup>91</sup>

The importance of this distinction lies in the fact that it shaped the thinking around contractual remedies: they would be primarily entitlement-based. The inquiry when awarding compensation for breach of contract was not what the defendant had done

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<sup>90</sup> DJ Ibbetson *A Historical Introduction to the Law of Obligations* (1999) 87.

<sup>91</sup> 88-89.

wrong, or even what losses the plaintiff had suffered. Rather, the focus was on what the plaintiff was entitled to – his expectations. This focus also led to the current position in common law that fault is relevant for tort, but not in contract. Contractual remedies came to be entitlement-based, and tortious remedies wrong-based.

As a consequence, the assessment of contractual damages had as its primary focus the expectations of the plaintiff, and not the fault of the defendant. By the seventeenth century the expectations-based rule for assessing damages was well-established.<sup>92</sup> This rule had to be refined to deal with cases where a plaintiff claimed for consequential loss. In such cases, it was held that a plaintiff could only claim damages for the natural, direct, or necessary consequences of the defendant's breach.<sup>93</sup>

This rule was absorbed into the reasonable contemplation test as set out in the seminal case of *Hadley v Baxendale* ("*Hadley*").<sup>94</sup> Here the court combined the idea that only natural consequences of the breach can be claimed with the foreseeability principle as set out by Pothier.<sup>95</sup> It is believed that this was under the influence of the contemporaneous work on damages by the American author Theodore Sedgwick.<sup>96</sup> In his work, he emphasised that a decision about the extent of damages is not aimed at fully compensating all losses, but rather at dividing losses fairly between parties according to the circumstances of each case.<sup>97</sup>

The *Hadley* decision seemed to follow this view of liability for damages as a more reasonableness-based decision, reflected in the foreseeability requirement, rather

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<sup>92</sup> 213. Ibbetson cites *Lowe v Peers* (1768) 4 Burr 2225.

<sup>93</sup> *Boorman v Nash* (1829) 9 B. & C. 145 and *Walton v Fothergill* (1835) 7 C. & D. 392 as cited in AWB Simpson "Innovation in Nineteenth Century Contract Law" 1975 91 LQR 247 274; J Chitty *Treatise on Pleading* 5 ed (1831) 1.371 as cited in Ibbetson *A Historical Introduction to the Law of Obligations* 229.

<sup>94</sup> [1854] 9 Ex. 341.

<sup>95</sup> Simpson 1975 LQR 274.

<sup>96</sup> T Sedgwick, *A Treatise on the Measure of Damages, or An Inquiry into the Principles which Govern the Amount of Compensation Recovered in Suits at Law* 1 ed (1847). The influence of this work on the decision in *Hadley v Baxendale* is mentioned by Simpson 1975 LQR 276 and Ibbetson *A Historical Introduction to the Law of Obligations* 231.

<sup>97</sup> T Sedgwick *A Treatise on the Measure of Damages* 64, 112.

than the mechanical discovery of causal relationships.<sup>98</sup> The court formulated a rule for the limitation of liability for damages as follows:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of the contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.”<sup>99</sup>

The rule was formulated as two alternatives:<sup>100</sup> either a defendant was liable for damages because the loss suffered by the plaintiff was the natural and direct consequence of his breach, or he was liable because the loss suffered was reasonably supposed to have been contemplated by both parties as a probable consequence of the breach. The second part is essentially based upon Pothier’s work – one difference is the emphasis placed on the foreseeability of damage by both parties as opposed to Pothier’s reference to only the defendant.<sup>101</sup> Additionally, Pothier’s further rule determining that a defendant would be liable for even unforeseen consequences if his breach was fraudulent was not incorporated in this test.<sup>102</sup>

Briefly summarised, *Hadley* determined that a plaintiff can recover all losses suffered as a natural consequence of the breach in the usual course of things as well as those losses that could have reasonably been contemplated by the parties.<sup>103</sup> This approach differs from the position set out by Pothier and adopted in modern French law. The French position regards “direct consequences” as a wider concept than “foreseeable or contemplated” consequences and holds the defendant liable for the former only in cases of intentional breach. As the *Hadley* test developed, English law came to regard “direct” consequences as those that are deemed to have been contemplated.

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<sup>98</sup> Ibbetson *A Historical Introduction to the Law of Obligations* 231.

<sup>99</sup> *Hadley v Baxendale* [1854] 9 Ex 341 para 354.

<sup>100</sup> Simpson 1975 *LQR* 277.

<sup>101</sup> Ibbetson *A Historical Introduction to the Law of Obligations* 232.

<sup>102</sup> Gordley “Responsibility in Crime, Tort and Contract for Unforeseen Consequences of an Intentional Wrong” in *The Law of Obligations – Essays in Honour of John Fleming* 205.

<sup>103</sup> H Beale *Remedies for Breach of Contract* (1980) 179.

The approach set out in *Hadley*, despite combining two different tests, has often been treated as one single test for remoteness of damages,<sup>104</sup> consisting of two limbs.<sup>105</sup> This is seen in the manner in which the rule was restated in *Victoria Laundry (Windsor Ltd) LD v Newman Industries LD* (“*Victoria Laundry*”).<sup>106</sup> Here the court held that, where a loss is the natural and direct consequence of a breach, it is deemed to have been in the contemplation of the parties and is therefore recoverable. Where this is not the case, the loss could still be recovered if it could be proven to have been in the contemplation of both parties based on their actual knowledge of special circumstances.<sup>107</sup>

The court therefore set out the foreseeability approach to remoteness of damages as one rule – operating with reference to two types of knowledge. What is considered foreseeable by parties is dependent on knowledge: imputed (in cases where the loss was a natural and direct consequence of the breach) or actual (where there was knowledge of special circumstances rendering the loss foreseeable). If damage was foreseeable, it can be recovered.

The distinction between “natural” or “usual” losses and unusual losses should not be equated with the distinction between direct and consequential losses. Rather, the former distinction focuses on those direct or consequential losses that are deemed sufficiently foreseeable in the light of the nature of the breach, and those that are not.<sup>108</sup> Such foreseeable losses may be direct or consequential. It has been argued that these two different distinctions make the operation of the rule uncertain.<sup>109</sup>

To address this, early cases following *Hadley* had interpreted its test to require proof of a tacit agreement when damages for unusual loss were claimed.<sup>110</sup> Courts held that, where the loss was not the natural consequence of a breach, a party could only recover damages if he could prove that the defendant expressly or tacitly contracted

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<sup>104</sup> E McKendrick *Contract Law – Texts, Cases and Materials* 2 ed (2006) 1081.

<sup>105</sup> HG Beale *Chitty on Contracts* I 31 ed (2012) 26-104.

<sup>106</sup> (1949) 2 KB 528.

<sup>107</sup> G Treitel *The Law of Contract* 14 ed (2015) 965-967.

<sup>108</sup> Beale *Remedies for Breach of Contract* 181.

<sup>109</sup> 180.

<sup>110</sup> *British Columbia and Vancouver's Island Spar, Lumber and Saw-Mill Co v Nettleship* (1868) LR 3 CP 499; *Horne v Midland Railway* (1873) LR 7 CP 583.

to pay such damages. But by the beginning of the twentieth century this interpretation had been discredited.<sup>111</sup> It is now widely accepted that the reasonable contemplation test in English law does not require proof of a tacit agreement between parties in order for liability for damages to arise.<sup>112</sup> If the knowledge that the parties had of special circumstances was of such a nature that it rendered the loss in question reasonably foreseeable, that loss would be recoverable.

#### 2 4 2 The Assumption of Responsibility Test

There are recent developments in English law which seem to indicate a movement back towards a tacit agreement requirement. This can be seen in the adoption of the “assumption of responsibility” test in the decision of *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* (“*The Achilleas*”).<sup>113</sup> This decision incorporated earlier reasoning by courts that foreseeability only serves as an indication of what the parties had intended at contract conclusion.<sup>114</sup> Therefore, according to the court, the real inquiry should focus on the intentions of parties and what they had agreed upon. This can be determined by considering different factors. One of these factors – arguably the most important one – would be foreseeability.

The *Achilleas* decision incorporated this reasoning into a single test for remoteness, referred to as the assumption of responsibility test. The court stated that a defendant can only be liable for damage that lie within the scope of the responsibilities that he had assumed in terms of the contract.<sup>115</sup> The adoption of this test signals a more agreement-focussed approach to contractual damages.

The test for whether or not there had been assumption of responsibility entails “the interpretation of the contract as a whole against its commercial background”.<sup>116</sup> Lord

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<sup>111</sup> A Kramer “An Agreement-Centred Approach to Remoteness and Contract Damages” in N Cohen & E McKendrick (eds) *Comparative Remedies for Breach of Contract* (2005) 250.

<sup>112</sup> Beale *Chitty on Contracts* I 26-104; AL Corbin *Contract Law* 5 1014.

<sup>113</sup> [2009] 1 AC 61.

<sup>114</sup> *GKN Centrax Gears Ltd v Matbro Ltd* 1976 Lloyd’s Rep 555 (CA) 58.

<sup>115</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2009] AC 61 92.

<sup>116</sup> Kramer *The Law of Contract Damages* 291, citing *Satef-Huttenes Albertus Spa v Paloma Tercera Shipping Co SA (The Pegase)* [1981] 1 Lloyd’s Rep 175 183; *Mulvenna v Royal Bank of Scotland Plc* [2003] EWCA Civ 1112; *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2009] AC 61.

Hoffmann stated that the court must determine what a reasonable observer would understand the contracting party to have undertaken. Ordinarily, this will be compensation for any loss which the parties would reasonably regard as likely to flow from the breach. However, there are many cases where a reasonable man would consider that more, or less, responsibility had been accepted.<sup>117</sup> An example might be a contract where it is common knowledge between the parties that the buyer will re-sell the *merx* and that the quality of that *merx* will impact on his business reputation. In such a case a reasonable person might consider the seller to have accepted responsibility for the loss of business reputation caused by a breach.

The assumption of responsibility test does not replace the traditional contemplation test. Rather, reasonable contemplation reflects what parties can be deemed to have assumed responsibility for.<sup>118</sup> Foreseeability therefore is seen as a means to an end, rather than an end in itself. In other words, foreseeability serves as an indication of the deemed intention of the parties – and it is on this basis that liability is imposed.

As will be seen in the next section, South African courts greatly relied on English law when developing their approach to the limitation of contractual damages, often referring to the *Hadley* test in the formulation of the contemplation requirement. The next section will also illustrate how the two different limbs of the *Hadley* test came to be conflated into one. Finally, the next section also explores how the South African convention principle developed and is currently applied. This is an issue that is better understood when approached with the background of the English assumption of responsibility test. The relevance of an agreement between parties has been approached differently in South African law, but as we will see – there is a shared emphasis on agreement to be liable for damages over and above the mere foreseeability of that damage.

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<sup>117</sup> L Hoffmann “The Achilleas: Custom and Practice or Foreseeability?” (2010) 14 *Edin L Rev* 47 58.

<sup>118</sup> Kramer *The Law of Contract Damages* 291.

## 2 5 South African law

### 2 5 1 Overview

As South African law currently stands, damage is categorised as loss that flows naturally and generally from a breach of contract, and loss that does not. The former can be recovered as general damages, and the latter as special damages.<sup>119</sup> General damages are deemed by law to have been contemplated by the parties and can therefore, in principle, always be recovered.<sup>120</sup> A plaintiff need only prove that the particular loss was of the kind<sup>121</sup> that flow naturally and generally from the type of breach in question.

As a point of departure, special damages is considered too remote and cannot be recovered. However, in certain circumstances a plaintiff will be able to claim special damages. First, a plaintiff has to prove that there are special circumstances which make it reasonable to presume that the parties contemplated the loss as a probable result of the breach, or alternatively that the loss was actually contemplated by the parties.<sup>122</sup> This requirement that the loss was presumably or actually contemplated by the parties is referred to as the contemplation principle.<sup>123</sup> Secondly, a plaintiff also has to prove that the parties entered into the contract with these special circumstances in view,<sup>124</sup> or (under a strict formulation of the test) that parties had tacitly or expressly contracted that the defendant would be liable for such damages.<sup>125</sup> This is referred to as the convention principle.<sup>126</sup> The next section explores how our courts developed our approach as it currently stands.

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<sup>119</sup> Van der Merwe et al *Contract* 367-368.

<sup>120</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687D.

<sup>121</sup> *BAT Rhodesia Ltd v Fawcett Security Organisation (Salisbury) Ltd* 1972 4 SA 103 (R) 104E.

<sup>122</sup> Van der Merwe et al *Contract* 369.

<sup>123</sup> *Shatz Investments (Pty) Ltd v Kalovyrynas* 1976 2 SA 545 (A) 552B.

<sup>124</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 169.

<sup>125</sup> 177.

<sup>126</sup> *Shatz Investments (Pty) Ltd v Kalovyrynas* 1976 2 SA 545 (A) 552C.



## 2 5 2 Historical Development

### 2 5 2 1 *Early contemplation tests and the development of a test for the recovery of general damages*

Early South African case law on remoteness in contract focussed their inquiry on whether or not damage was capable of being contemplated. In one of the earliest cases on the issue, *Stent v Gibson Brothers*,<sup>127</sup> the court held that:

“[t]he question seems to come to this: was the [damage] a matter of such ascertainable value [at the time of contract conclusion], as to have been capable of contemplation by both parties? If it was not ascertainable then, it is difficult to see how it could have formed part of the contract, and if it did not form part of the contract, it could not enter into damages for breach.”<sup>128</sup>

This statement was made with reference to early English case law<sup>129</sup> that preceded the seminal *Hadley* decision. Subsequent to the *Hadley* decision, South African courts formulated this objective test with an emphasis on the question whether or not a defendant could be deemed to have submitted to liability for damages. This was done with reference to other authorities as well. In *Transvaal Silver Mines (Limited) v E. Brayshaw*<sup>130</sup> the court referred to Pothier<sup>131</sup> to state that a defendant will only be liable for losses arising from breach that he might have contemplated. According to the court the reason for the rule is that the defendant could only have intended to submit to damages that he might have contemplated.<sup>132</sup> The court stated that this “is also in accordance with the well-known case of *Hadley*”.<sup>133</sup>

The test was an objective one. The question was whether or not it would be reasonable to presume that parties contemplated and submitted to liability for damages – not if they actually did. If losses could have been contemplated, it was deemed that the defendant had submitted to liability for such damages. This was explicitly confirmed in

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<sup>127</sup> 1888-1889 5 HCG 148.

<sup>128</sup> 151.

<sup>129</sup> *Watson v Ambergate Railway Company* Jur. 15 (1851) 448.

<sup>130</sup> *Transvaal Silver Mines (Limited) v Brayshaw* 1895 OR 95.

<sup>131</sup> *Evans RJ Pothier: A Treatise on the Law of Obligations* para 160.

<sup>132</sup> *Transvaal Silver Mines (Limited) v Brayshaw* 1895 OR 95 102.

<sup>133</sup> 102.

*Erasmus v Russell's Executor*<sup>134</sup> where the court held that a defendant would be liable for damages

"...though he had no express knowledge, [if] the circumstances were such that he must be considered to have had knowledge."<sup>135</sup>

Courts came to refer to damages that can reasonably be presumed to have been in contemplation of the parties as damages that flow "naturally and generally" from a breach of contract. This was concisely formulated in *Steenkamp v Du Toit*.<sup>136</sup>

"[A] person who has rendered himself liable for damages is responsible for the natural and probable consequences of his act, those consequences being ascertained with reference to the defendant's knowledge at the time. A man, therefore, who has failed to carry out his contractual obligation, is liable for such damages as he must reasonably have known would naturally and probably result from the breach, such damages, in other words, as given his knowledge of the circumstances might naturally be expected to flow from the breach."<sup>137</sup>

Damages that are objectively considered to be the natural and general consequences of a particular breach came to be referred to as general damages.<sup>138</sup> When damage was the natural result of a breach, and therefore gave rise to a claim for general damages, there was no need to consider contemplation, as was confirmed in *Emslie v African Merchants* ("*Emslie*"): <sup>139</sup>

"a plaintiff must show either that damages he claims were in the contemplation of the parties at the time of entering into the contract, or are the direct, proximate and natural result of the breach of contract."<sup>140</sup>

It was with reference to *Emslie* that Innes CJ set out the test for remoteness in the milestone Appellate Division decision of *Victoria Falls & Transvaal Power Company v Consolidated Langlaagte Mines Ltd* ("*Victoria Falls*"): <sup>141</sup>

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<sup>134</sup> 1904 TS 365.

<sup>135</sup> 376.

<sup>136</sup> 1910 TS 171.

<sup>137</sup> 175.

<sup>138</sup> Erasmus & Gauntlett "Damages" in *LAWSA* 7 para 15.

<sup>139</sup> 1908 22 EDC 82.

<sup>140</sup> 90.

<sup>141</sup> 1915 AD 1.

“Such damages only are awarded as flow naturally from the breach or as may reasonably be supposed to have been in the contemplation of the contracting parties as likely to result therefrom.”<sup>142</sup>

The first scenario under which damages would be recoverable – if the loss flows naturally from the breach – became the accepted formulation of the test for general damages that is still accepted today.<sup>143</sup> The position was eloquently formulated later by Wessels JA:

“The damages should be such as may be fairly and reasonably be considered arising naturally according to the usual course of things. This is the only damage which according to the usual course of things both parties must be held by law to have contemplated.”<sup>144</sup>

The second scenario deals with all damages that cannot be considered to flow naturally from a breach in question – special damages.<sup>145</sup> The test for the recovery of special damages saw significant development subsequent to *Victoria Falls*, and lies at the heart of much of the criticism of our current approach.

#### 2 5 2 2 *The development of a test for the recovery of special damages*

As can be seen in the statement quoted from *Victoria Falls* above, if damages did not flow naturally and generally from a breach of contract, it may still be recovered. According to Innes CJ, in such cases a plaintiff would have to prove that the damages:

“may reasonably be supposed to have been in the contemplation of the contracting parties as likely to result [from the breach].”<sup>146</sup>

If the circumstances surrounding the contract render it reasonable to suppose that the parties could have contemplated the damages as likely to result from the breach of contract, such damages can be recovered. This requirement is still applied today, but an additional requirement was soon formulated.

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<sup>142</sup> 22.

<sup>143</sup> Van der Merwe et al *Contract* 367.

<sup>144</sup> *Lavery and Co Ltd v Jungheinrich* 1931 AD 156 174.

<sup>145</sup> Erasmus & Gauntlett “Damages” in *LAWSA* 7 para 15.

<sup>146</sup> *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines* 1915 AD 1 22.

In *Lazarus Bros v Davies & Kamann* (“*Lazarus Bros*”)<sup>147</sup> the court, relying on MacKeurtan,<sup>148</sup> decided that the mere fact that parties can be presumed to have contemplated damage is not sufficient for the recovery of special damages. Additionally,

“...it must be clear that [the defendant] contracted in such circumstances that the other party has rightly assumed consent upon his part to become liable for special damage upon breach. In other words, it must be clear that the aggrieved party at the time of contract relied upon him to prevent the damage, and that he, in his turn, led the other party to believe that he was willing to assume the extra burden or extra risk... [T]he origin of “special damages” is conventual.”<sup>149</sup>

For this conclusion MacKeurtan relied on early English case law which had, soon after the *Hadley* decision, interpreted its rule to require proof of a tacit agreement to recover losses that had not arisen naturally from the breach.<sup>150</sup> By the time of the *Lazarus Bros* decision, however, this idea had been rejected in England.<sup>151</sup>

The question of recoverability of special damages came before the Appellate Division in the case of *Lavery and Co Ltd v Jungheinrich* (“*Lavery*”).<sup>152</sup> Curlewis JA formulated the general rule that damages will only be recoverable if it would be reasonable to suppose that it had been in the contemplation of the parties at contract conclusion.<sup>153</sup> According to Curlewis JA, such a conclusion could possibly be drawn from the subject matter of the contract, but he held that in most cases the special circumstances surrounding contract conclusion would be decisive. This principle later became known as the “contemplation” requirement.<sup>154</sup> In terms of this requirement, therefore, a court will look at circumstances surrounding contract conclusion and the parties’ knowledge at that time to determine if it would be reasonable to suppose that parties did contemplate the losses in question.

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<sup>147</sup> 1922 OPD 88.

<sup>148</sup> HG MacKeurtan *The Sale of Goods in South Africa* (1921) 363-364.

<sup>149</sup> *Lazarus Bros v Davies & Kamann* 1922 OPD 88 91, quoting from MacKeurtan *Sale of Goods* 364.

<sup>150</sup> *British Columbia v Nettleship* (1868) LR 3 CP 499; *Horne v Midland Railway* (1873) LR 7 CP 583.

<sup>151</sup> Kramer “An Agreement-Centred Approach to Remoteness and Damages” in *Comparative Remedies for Breach of Contract* 250.

<sup>152</sup> 1931 AD 156.

<sup>153</sup> 169.

<sup>154</sup> *Shatz Investments (Pty) Ltd v Kalovyrynas* 1976 2 SA 545 (A) 552B.

Curlewis JA went further, however. He stated that special damages will not be recoverable merely because the parties can be presumed to have contemplated the damage. In addition, parties must have contracted on the basis of such knowledge.<sup>155</sup> This principle – which was in keeping with the principle set out in *Lazarus Bros*,<sup>156</sup> became known as the “convention” principle.<sup>157</sup>

In his judgment, Wessels JA confirmed this idea. He held that special damages cannot be recovered only because it had been actually or presumptively contemplated. Additionally, the contract must have been concluded in the light of knowledge that rendered the damage foreseeable:

“If, however, special circumstances exist which show that both parties may reasonably be supposed to have contemplated other damages as the probable result of the breach of contract, then these damages may also be recovered. These special damages can, however, only be recovered if it is clear that both parties and not one party only knew of the circumstances, and if it can reasonably be inferred that the contract was entered into in view of these special circumstances.”<sup>158</sup>

The *Lavery* decision has therefore been interpreted as setting two requirements for the recovery of special damages.<sup>159</sup> First, damages have to be actually or presumptively contemplated by the parties (contemplation). Second, the parties must either have entered into the contract with knowledge and in view of either their actual contemplation, or in view of the circumstances that rendered it reasonable to presume that they contemplated the losses (convention).

When discussing the test for the recovery of special damages, courts have tended to conflate different authorities. In the *Lavery* decision Wessels JA referred to damages that do not flow naturally and generally from a breach of contract as extrinsic damages. This was done with reference to Pothier.<sup>160</sup>

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<sup>155</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 172.

<sup>156</sup> 1922 OPD 88.

<sup>157</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 (A) 552F.

<sup>158</sup> *Lavery and Co Ltd v Jungheinrich* 1931 AD 156 174-175.

<sup>159</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 (A) 552.

<sup>160</sup> *Lavery and Co Ltd v Jungheinrich* 1931 AD 156 175.

The terms special and general damages came to be used interchangeably with intrinsic and extrinsic damages in references to Pothier's work.<sup>161</sup> The Appellate Division has also equated the distinction between damages *intra* and *extra rem* (as introduced by the glossators in reference to Paul's rule in D 19.1.21.3) with the distinction between intrinsic and extrinsic damages.<sup>162</sup> These concepts of intrinsic, general and damages *intra rem* on the one hand, and extrinsic, special and damages *extra rem* on the other came, in turn, to represent the two different limbs of the *Hadley* test. This conflation is illustrated in *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd*.<sup>163</sup>

"[T]he defaulting party's liability is limited in terms of broad principles of causation and remoteness, to (a) those damages that flow naturally and generally from the kind of breach of contract in question and which the law presumes the parties contemplated as a probable result of the breach, and (b) those damages that, although caused by the breach of contract, are ordinarily regarded in law as being too remote to be recoverable unless, in the special circumstances attending the conclusion of the contract, the parties actually or presumptively contemplated they would probably result from its breach... [T]he damages described in limb (a) and the first rule in *Hadley v Baxendale* are often labelled "general" or "intrinsic" damages while the second rule in *Hadley v Baxendale* is called "special" or "extrinsic" damages..."<sup>164</sup>

### 2 5 3 Criticism of the current position

The approach to remoteness in contract that is currently followed in our law has been shrouded in controversy and uncertainty. One of the issues raised by academics and courts is the distinction between general and special damages. It is argued that the distinction is rigid because it classifies damages with reference to criteria that do not necessarily contribute to the process of limiting liability for damages.

In addition to criticism directed at its usefulness,<sup>165</sup> the distinction has also been criticised for leading to unfair results. This is because the foreseeability of general

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<sup>161</sup> JA Wessels *The Law of Contract in South Africa II* (1937) 935-936; *Whitfield v Phillips* 1957 3 SA 318 (A) 329E; *Shatz Investments (Pty) Ltd v Kalovyrmas* 1976 2 SA 545 (A) 550B-550C.

<sup>162</sup> *Whitfield v Phillips* 1957 3 SA 318 (A) 329D.

<sup>163</sup> 1977 3 SA 670 (A)

<sup>164</sup> 687D-688C.

<sup>165</sup> JC De Wet & AH Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 5 ed (1992) 204.

damage can only be proven with reference to the contract itself.<sup>166</sup> The result is that there will be cases where circumstances are known to both parties and damage is therefore clearly foreseeable; but this foreseeability will not make the defendant liable for general damages. Damage arising out of such known circumstances may also not necessarily be recoverable as special damages. Recovery of special damages requires proof of both contemplation and convention. Much of the discomfort with the current approach followed by our courts can therefore be said to lead back to criticism of the convention requirement.

The imposition of the convention requirement – that is, requiring consensus before imposing liability for special damages – has been criticised both by academics and in case law subsequent to *Lavery*.<sup>167</sup> Academics argue that the convention principle is premised upon a fiction. At the time of concluding a contract, parties usually contemplate performance of the contract and not its breach. It is highly unlikely that the parties would agree that the defendant would be liable for special damages in the event of breach of contract when they have not even considered the possibility of such a breach in the first place.<sup>168</sup>

It has been also been brought into question whether or not *Lavery* should be interpreted as requiring proof of a tacit agreement. Although it is clear that this is the Appellate Division's interpretation of *Lavery*,<sup>169</sup> it has been criticised as incorrect. Mulligan has argued that the convention principle as it stands in our law today is not a proper interpretation of Pothier, or even a proper interpretation of the *Lavery* decision.<sup>170</sup>

Pothier's texts have sometimes been interpreted by our courts in a manner that does not require convention for the recovery of special damages.<sup>171</sup> It has been suggested that Pothier only meant that where special damage is sufficiently foreseeable due to surrounding circumstances, the law deems the defendant to have submitted to liability

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<sup>166</sup> Van der Merwe et al *Contract* 370.

<sup>167</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156.

<sup>168</sup> De Wet & Van Wyk *Kontraktereg en Handelsreg* I 205.

<sup>169</sup> *Shatz Investment (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 552D, 553G, 554F-554G.

<sup>170</sup> GA Mulligan "Damages for Breach: Quantum, Remoteness and Causality" (1956) 73 SALJ 27 38.

<sup>171</sup> *Bower v Sparks, Young and Farmers' Meat Industries* 1936 NPD 1 13.

for it.<sup>172</sup> This interpretation can imply that once special circumstances sufficiently establish that the relevant damage was in the actual or presumptive contemplation of parties, there is no need also to prove that the defendant had contracted to pay such damages.

It has been argued by Lubbe and Murray that this is what Wessels JA intended in *Lavery*, and that his words have been misinterpreted to mean that there must be proof of a tacit agreement to pay damages.<sup>173</sup> Particularly, they note his statement that

“loss of business is certainly not general damage, nor is it such special damage as the party sought to be held liable could have reasonably contemplated... The defendant could only be held liable if he in such a case had contracted that he would pay damage for loss of business...”<sup>174</sup>

Arguably therefore, Wessels JA meant that where losses are too remote to be recovered as special damages, they can still be recovered if a plaintiff can prove an agreement (tacit or express) to that effect.<sup>175</sup> Contributing to the uncertainty surrounding the issue, there have been numerous cases dealing with special damages that do not refer to the convention requirement and only focus on contemplation.<sup>176</sup>

A final source of uncertainty stems from the fact that the courts determine recoverability of damages with reference to the time of contract conclusion and not at the time of breach of contract. As De Wet and Van Wyk argue, if parties do not contemplate the consequences of breach at the time of contract conclusion, there is no reason to determine foreseeability at that time.<sup>177</sup>

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<sup>172</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 SA 553D.

<sup>173</sup> Lubbe & Murray *Contract: Cases, Materials, Commentary* 627.

<sup>174</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 176-177.

<sup>175</sup> Lubbe & Murray *Contract: Cases, Materials, Commentary* 627.

<sup>176</sup> RH Christie & GB Bradfield *The Law of Contract in South Africa* 6 ed (2011) 576 list: *Mills v Mangquteli* 1911 EDC 228, *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22, *Jockie v Meyer* 1945 AD 345 363, *Bhayla v Cassim* 1945 NPD 208 213, *Van der Watt v Louw* 1955 1 SA 690 (T), *Whitfield v Phillips* 1957 2 SA 318 (A) 325-6 329; Van der Merwe et al *Contract* 369 list: *Bellairs v Hodnett* 1978 1 SA 1109, *Rens v Coltman* 1996 1 SA 452 (A), *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* 2011 4 AD 156.

<sup>177</sup> 87.



The opposing argument that has been accepted by the Appellate Division<sup>178</sup> is that the rights and duties of the parties are set at contract conclusion, and therefore the contemplation of the parties would have to be determined at that time.<sup>179</sup> This argument has not silenced the academic debate on the issue, however.<sup>180</sup>

The criticism levelled against the current approach to remoteness in contract has been acknowledged by our courts.<sup>181</sup> However, beyond highlighting the controversy surrounding the convention principle in *Shatz Investments (Pty) Ltd v Kalovyrnas*<sup>182</sup> it has not been found necessary to decide on the issue. In subsequent cases where the issue was raised, the court found that the facts of the case dealt with general rather than special damages.<sup>183</sup> It is expected that, when the court will decide on the matter, the convention principle will be rejected.<sup>184</sup>

The latest development in this area of our law is the suggestion made in *Thoroughbred Breeders' Association v Price Waterhouse*<sup>185</sup> to adopt an alternative approach. According to the court, consideration should be given to the possible adoption of a flexible or supple approach similar to the one used in the law of delict and criminal law.<sup>186</sup> The court describes the suggested approach as follows:

“[T]he competence of parties to regulate, limit or expand by arrangement amongst themselves the consequences of any prospective breach... must of course be accommodated in any flexible test... Both limbs of the current conventional test can readily be blended and integrated as being relevant factors to be taken into account. The fact that both parties had particular consequences in mind when they concluded the contract will

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<sup>178</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 (A) 551D-551H.

<sup>179</sup> AL Corbin *A Comprehensive Treatise on the Working Rules of Contract Law* 5 (1964)1007.

<sup>180</sup> Van der Merwe et al *Contract* 370.

<sup>181</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 (A) 551B; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687F; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 580B.

<sup>182</sup> 1976 2 SA 545 (SCA) 551B.

<sup>183</sup> *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 (SCA) 554F; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 688A; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 581J and 582D;

<sup>184</sup> *Christie & Bradfield Contract in South Africa* 577, with reference to *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 SA 554E.

<sup>185</sup> 2001 4 SA 551 (SCA).

<sup>186</sup> 582F.

still be conclusive. There are many instances where the time of breach will be more appropriate than the time of contract. The circumstances of each case will determine where the emphasis belongs. Reasonable foreseeability, one imagines, will govern most but not all cases.”<sup>187</sup>

The possible implications of this alternative approach will be evaluated later in the research with reference to the various theories of remoteness.

## 2 6 Conclusion

This chapter provided an overview of the development of the limitation of contractual damages across different civilian and common-law jurisdictions. The aim of this overview was to place the current South African approach, the authority that it relies on, and the difficulties that it experiences, in context.

We have seen that classical Roman law, although dealing with the issue in certain contexts, did not provide a principled approach to the limitation of contractual damages. In addition, the rules that did exist were often convoluted and their implications were uncertain. The rule set out by Justinian in C 7.47.1 was also explored, particularly with reference to its influence on the French jurists’ approach to the limitation of contractual damages.

As we have seen, Justinian’s rule came to be explained in terms of foreseeability by the French jurists. This chapter illustrated how the work of especially Pothier developed a foreseeability-based approach to the limitation of contractual damages. The rules that he set out, including his distinction between intrinsic damages (for loss suffered in respect of the thing that is the object of the breached obligation) and extrinsic damages (for loss that is not suffered in respect of the thing that is the object of the breached obligation), were adopted in South African law.

Brief mention was made of another modern civilian jurisdiction: Germany. The chapter provided a cursory overview of the adequate cause approach followed there. The further elaboration of the adequate cause theory in the form of the *Schutzzwecklehre* was briefly explained and similarities between its premise and that of the foreseeability

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<sup>187</sup> 583A-583C.

approach used in French law was highlighted. This issue will be further explored when dealing with the adequate cause theory in more detail.

As we have seen, South African courts have primarily relied upon English decisions and terminology when developing the current approach. The classic decision of *Hadley* and the reasonable contemplation test as developed in English law was briefly explored. This test has two limbs. Losses are either recoverable because they arose naturally according to the usual course of things from the breach of contract; or because it can reasonably be supposed to have been in the contemplation of the parties. The latest development in England – the assumption of responsibility test – seems to move away from this objective perspective. Rather, it seeks to ascertain the intentions of parties. This is done by determining whether or not the defendant had assumed responsibility for the damage that his breach caused. This development was briefly discussed and will be further explored later in the study. A thorough understanding of this development seems especially important in the light of the controversy in South African law regarding the convention requirement.

Finally, this chapter has provided an overview of the development of the current South African approach to the limitation of contractual damages. We have seen how our courts have developed a contemplation test that is objective in nature. The test for whether damage should be deemed to have been contemplated by parties (and therefore be recoverable as general damages) came to centre on whether the damage was a natural result of the breach in the normal course of events.

In the case of special damages – where losses are not the natural result of a breach and therefore not deemed to have been contemplated by law – the South African approach imposes two requirements which must be met before a defendant will be liable. First, the parties must actually or presumptively have contemplated the damage as a probable result of the breach of contract (the contemplation requirement). Secondly, the parties must have entered into the contract on the basis of their knowledge of the circumstances that makes the particular damage a probable result of the breach (the convention requirement). The convention and contemplation requirements as formulated seem to have involved the conflation of several separate authorities. The problematic nature of this has briefly been explored and will become

apparent when the study turns to an in-depth discussion of the different approaches to remoteness in contract.

Finally, the criticism and uncertainty surrounding the current approach has been discussed. It seems clear that there are a number of problematic aspects of our current approach that merits further discussion. These are firstly whether or not convention should be a requirement for the recovery of special damages; secondly, whether or not the time of contract conclusion is the correct time to determine contemplation; and thirdly, whether or not the distinction between general and special damages should be maintained. All of these issues will be addressed in the subsequent chapters with reference to the different theories of remoteness: direct consequences, adequate cause, and foreseeability.

## CHAPTER 3: THE DIRECT CONSEQUENCES THEORY

### 3 1 Introduction

South African authors generally identify three alternative theories that could underlie an approach to the limitation of contractual damages: the direct consequences theory, the adequate cause theory, and the foreseeability theory.<sup>1</sup> In the following chapters each of these theories will be analysed and evaluated. The aim, ultimately, is to provide a concise overview of each of these different theories and review their possible implications for the South African approach to the issue of remoteness of contractual damages. It is hoped that such an analysis would be able to help shed light on suitable solutions to the challenges currently seen in our law.<sup>2</sup> This chapter will focus on the direct consequences theory.

The direct consequences theory as a normative justification for the limitation of liability for damages is found in English law.<sup>3</sup> It was originally formulated in the tort case of *In re an Arbitration between Polemis and another and Furness, Withy and Co. Ltd* ("*Polemis*").<sup>4</sup> Subsequent to that decision, it was argued that the theory is applicable both in cases of contract and tort,<sup>5</sup> although its suggested application to contract cases was heavily criticised<sup>6</sup> and it never really gained a foothold in English contract law. It is a theory that developed, was criticised and later largely discredited mostly in the arena of the law of tort.<sup>7</sup> Also in South Africa, the direct consequences theory has been discussed almost exclusively in the context of the law of delict.<sup>8</sup>

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<sup>1</sup> GF Lubbe & CM Murray *Farlam & Hathaway: Contract – Cases, Materials and Commentary* 3 ed (1988) 624; JM Potgieter, L Steynberg & TB Floyd Visser & Potgieter: *Law of Damages* 3 ed (2012) paras 11.5.4-11.5.5; AD Jansen Van Rensburg *Juridiese Kousaliteit en Aspekte van Aanspreeklikheidsbeperking by die Onregmatige Daad* LLD Thesis UNISA (1970) 189-226.

<sup>2</sup> 2 5 2.

<sup>3</sup> Jansen van Rensburg *Juridiese Kousaliteit* 216-217.

<sup>4</sup> [1921] 3 K.B. 560.

<sup>5</sup> AL Goodhart "The Imaginary Necktie and the Rule in *In Re Polemis*" (1952) 68 *LQR* 514 518-519.

<sup>6</sup> 519.

<sup>7</sup> WL Prosser "Palsgraf Revisited" in WL Prosser *Selected Topics on the Law of Tort – Five Lectures Delivered at the University of Michigan* (1953) 191 229-231.

<sup>8</sup> JC Van Der Walt & JR Midgley *Delict – Principles and Cases I* (1997) 168-173; RG McKerron *The Law of Delict* 6 ed (1965) 123-129; J Burchell *Principles of Delict* (1993) 119-120; PQR Boberg *The*

In the light of its rejection in England and the fact that it is primarily applied to cases of tort and delict, it might seem unusual to devote a chapter to the direct consequences theory. However, the theory does merit some discussion and evaluation, for at least two reasons.

First, the term “direct consequence” is often used by our courts when dealing with remoteness in contract.<sup>9</sup> In what is arguably the most quoted case,<sup>10</sup> *locus classicus*<sup>11</sup> on the matter, *Victoria Falls and Transvaal Power Co Ltd v Consolidated Langlaagte Mines*,<sup>12</sup> Innes C.J., for example, states that

“...damages for loss of profits can only be awarded when such loss is the direct, natural or contemplated result of non-performance.”<sup>13</sup>

Although these references cannot be interpreted to imply that our law follows the direct consequences test as understood in English law,<sup>14</sup> it is not at all clear what exactly is meant by “direct” when used by our courts. Indeed, the use of the term has been criticised by local authors as unsatisfactory and unclear.<sup>15</sup> The term “direct consequences” is also used in French law, and is then explained with reference to

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*Law of Delict I* (1984) 440-442; J Neethling, JM Potgieter & PJ Visser *Law of Delict* 4 ed (2001) 192-195.

<sup>9</sup> *Emslie v African Merchants Ltd* 1908 22 EDC 82 90; *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22; *Bower v Sparks, Young and Farmers' Meat Industries Ltd* 1936 NPD 1 17; *Administrator Natal v Edouard* 1990 3 SA 581 (A) 558; *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* 2011 (4) SA 276 (SCA) 291.

<sup>10</sup> *Probart v South African Railways and Harbours* 1926 EDL 205 209; *Hinz & Hinz v Kahlbester* 1933 SWA 96 98; *Whitfield v Phillips* 1957 2 SA 318 (A) 325; *Novick v Benjamin* 1972 2 SA 842 (A) 857; *Shatz Investments Pty Ltd v Kalovyrnas* 1976 2 SA 545 (A) 551; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 678; *Gloria's Caterers (Pty) Ltd t/a Connoisseur Hotel v Friedman* 1983 3 SA 390 (T) 393; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 579-581.

<sup>11</sup> *Gloria's Caterers (Pty) Ltd t/a Connoisseur Hotel v Friedman* 1983 3 SA 390 T 393.

<sup>12</sup> 1915 AD 1.

<sup>13</sup> 22.

<sup>14</sup> The direct consequences test as formulated in English law is seen as “opposing and irreconcilable” with foreseeability-based approaches – Van der Walt & Midgley *Delict I* 168.

<sup>15</sup> JC De Wet & AH Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 5 ed (1992) 228.

examples provided by Pothier.<sup>16</sup> As seen in the previous chapter,<sup>17</sup> our courts often rely on Pothier when dealing with issues of remoteness.

To analyse the implications of the direct consequences theory for the South African law of contract, a thorough understanding of its content and operation is therefore essential – if only to provide insight into the meaning of references to “directness” by our courts. In this respect, an overview of the traditional direct consequences theory as formulated in English law promises to be valuable.

Secondly, the traditional direct consequences test formulated in *Polemis* does, in terms of content and functioning, differ quite substantially from our current approach to remoteness.<sup>18</sup> These differences, and their implications for decisions relating to remoteness in contract, are worth evaluating if we are to have a holistic overview of the different approaches that could be adopted when limiting contractual damages.

## 3 2 The direct consequences theory in English law

### 3 2 1 Introduction

The direct consequences theory as formulated in English law holds that, as soon a defendant has acted wrongfully – or breached a contract<sup>19</sup> – he will be liable for all the direct consequences of his act, regardless of whether or not he could have foreseen those consequences.<sup>20</sup> The test was formulated in the landmark decision on the matter, *Polemis*, as follows:

“[T]he question to whether particular damages are recoverable depends only on the answer to the question whether they are the direct consequence of the act.”<sup>21</sup>

A consequence is considered to be the direct consequence of an act if there had been no new cause intervening between the specific act and the consequence.<sup>22</sup> Over time

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<sup>16</sup> B Nicholas *The French Law of Contract* 2 ed (1992) 229.

<sup>17</sup> 2 5.

<sup>18</sup> DJ Joubert *General Principles of the Law of Contract* (1987) 251; Boberg *Delict I* 442.

<sup>19</sup> H McGregor, M Spencer & J Picton *McGregor on Damages* 18 ed (2009) 121-123; 190.

<sup>20</sup> Neethling et al *Law of Delict* 192.

<sup>21</sup> *In re an Arbitration between Polemis and Another and Furness, Withy and Co. Ltd* [1921] 3 K.B. 560 574.

<sup>22</sup> Burchell *Principles of Delict* 119.

much has been done to elaborate on this admittedly vague definition. Prosser defines direct consequences as

“those which follow in sequence from the effect of the defendant’s act upon conditions existing and forces already in operation at the time, without the intervention of any external forces which come into active operation later.”<sup>23</sup>

Essentially, therefore, it would seem that a consequence is considered direct if there is no *novus actus* or *nova causa* identifiable in the sequence of events leading from the act of the defendant to the harm suffered by the plaintiff.<sup>24</sup> If this is the case, there will be liability for all such direct consequences regardless of whether they were foreseeable or not.

This test does not seem easy to apply. Deciding whether an intervening cause is new and independent enough to render consequences “indirect” often involves a determination that relies on policy considerations rather than the strict causal logic that the test seems to allude to. In a very telling description of the direct consequences test, it has been held that

“[i]n the varied web of affairs, the law must abstract some consequences as relevant, not perhaps on the grounds of pure logic, but simply for practical reasons.”<sup>25</sup>

The fact that the test is applied with an emphasis on practical considerations rather than purely logical reasoning is seen in the various ways in which courts decide whether intervening causes are independent “enough” to break the causal chain between an act and its negative consequences.<sup>26</sup> It has been described as a flexible approach by its supporters,<sup>27</sup> and complex and uncertain by opponents.<sup>28</sup> To gain some insight into how the test would be applied and what results it would yield, a brief overview of its historical development follows.

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<sup>23</sup> WL Prosser *Handbook of the Law of Torts* 4 ed (1971) 303. The same definition is used by Van der Walt & Midgley *Delict I* 172.

<sup>24</sup> Burchell *Principles of Delict* 119.

<sup>25</sup> *Liesbosch Dredger v SS Edison* [1933] A.C. 449 460.

<sup>26</sup> Boberg *The Law of Delict I* 442.

<sup>27</sup> 441.

<sup>28</sup> AL Goodhart “The Brief Life Story of the Direct Consequence Rule in English Tort Law” (1967) 53 *Va L Rev* 857 857.



### 3 2 2 Historical development

The history of the direct consequences theory can be traced back to the case of *Smith v The London and South Western Railway Company*.<sup>29</sup> In this case, Smith claimed damages from the railway company for the destruction of his cottage caused by a fire. During the summer, the railway company had cut grass and trimmed hedges next to the railway line. The refuse was placed in heaps next to the railway line and left there for two weeks. Because of a spark from a railway engine, a fire was started in the dried plant material. This fire spread to a field that did not belong to the defendant, crossed a road, and destroyed the plaintiff's cottage 180 meters away.<sup>30</sup>

The seven judges unanimously held the defendant liable for the damages claimed by the plaintiff.<sup>31</sup> Three of the judges maintained that the defendant was liable even though they admitted that the fire could not have been foreseen to spread in the way that it did.<sup>32</sup> However, it was argued that the foreseeability of the harm was not the proper test for liability:

“But I am of opinion that no reasonable man would have foreseen that the fire would consume the hedge and pass across a stubble-field, and so get to the plaintiff's cottage at the distance of 200 yards from the railway... but on consideration I do not feel that that is a true test of the liability of the defendants in this case.”<sup>33</sup>

The foreseeability principle was rejected by these judges because they felt that it would be too restrictive – that it would limit liability to an extent that would be too favourable to wrongdoers.<sup>34</sup> The judges had to formulate another principle in terms of which liability for damages could be limited. In this context, the notion that a defendant would be liable only for damage that can be said to be the direct consequence of his actions was formulated:

“I think the law is, that if they were aware that these heaps were lying by the side of the rails, and that it was a hot season, and that therefore by being left there the heaps were

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<sup>29</sup> (1870-1871) L.R. 6 C.P. 14.

<sup>30</sup> 14.

<sup>31</sup> Goodhart *Va L Rev* 1967 859.

<sup>32</sup> *Smith v The London and South Western Railway Company* (1870-1871) L.R. 6 C.P. 14 20.

<sup>33</sup> 20.

<sup>34</sup> Goodhart *Va L Rev* 1967 860.

likely to catch fire, the defendants were bound to provide against all circumstances which might result from this, and were responsible for all the natural consequences of it.”<sup>35</sup>

The idea formulated therefore was that once negligence was established, a defendant should be liable for all the “natural” consequences of their conduct. This concept was later formulated as “direct” consequences.

*Weld-Blundell v Stephens*<sup>36</sup> formed the primary authority for the later *Polemis* decision and applied the direct consequences theory within a contractual context. The case concerned breach of an implied term in a contract of employment. Mr Weld-Blundell, the plaintiff, had employed Mr Stephens, a chartered accountant. Mr Weld-Blundell wrote a letter to Mr Stephens that contained some libellous information about two officials at the company. Mr Stephens, in breach of an implied duty of care, gave the letter to his partner who negligently left it lying in the company’s office. The manager found the letter and disclosed its libellous contents to the two employees that Mr Weld-Blundell had written about.

This led to an action for libel against Mr Weld-Blundell, who had to compensate the parties to whom he referred in his letter. He in turn sought to recover that loss in an action for damages against Mr Stephens. He argued that, were it not for Mr Stephens’ breach of an implied duty of care, the information would not have become public and he would not have been liable for his libellous statements.<sup>37</sup>

The court had to consider whether the loss suffered because of Mr Stephens’ breach was too remote. In the dissenting judgment of Viscount Finlay, he answered this question with reference to the contemplation of the parties. He considered whether Mr Stephens could have foreseen the possibility of his carelessness causing the harm suffered by Mr Weld-Blundell.<sup>38</sup>

In the majority judgment of Lord Sumner however, the question of remoteness was answered not with reference to whether such harm could have been foreseen, but rather with reference to whether the harm was a direct consequence of the breach.

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<sup>35</sup> *Smith v The London and South Western Railway Company* (1870-1871) L.R. 6 C.P. 14 20.

<sup>36</sup> *Weld-Blundell v Stephens* [1920] A.C. 956.

<sup>37</sup> 956.

<sup>38</sup> 970.

In determining whether the damage was too remote, Lord Sumner expressed his preference for the term “direct consequence”:

“What are the ‘natural, probable and necessary consequences?’ Everything that happens, happens in order of nature and is therefore ‘natural.’ Nothing that happens by the free choice of a thinking man is ‘necessary,’ except in the sense of predestination. To speak of ‘probable’ consequence is to throw everything upon the jury. It is tautologous to speak of ‘effective cause’ or to say that damages too remote from the cause are irrecoverable, for an effective cause is simply that which causes, and in law what is ineffective or too remote is no cause at all. I still venture to think that direct cause is the best expression... Direct cause excludes what is indirect, conveys the essential distinction, which *causa causans* and *causa sine qua non* rather cumbrously indicate, and is consistent with the possibility of the concurrence of more direct causes than one...”<sup>39</sup>

The court held that, although the disclosure of the contents of the letter could have been foreseeable, the limits of liability should be determined with reference to whether or not the harm is a direct consequence of the breach. In this case, the fact that the manager had taken the letter constituted a *novus actus* that excluded “directness” by breaking the causal chain.

These statements formed the main authority for the *Polemis* decision and the subsequent acceptance of the direct consequences theory. *Polemis* was a tort case, in which the plaintiffs claimed for the value of their ship that had been destroyed by a fire caused by the negligence of the defendant’s employees. The cargo ship had containers with petrol which leaked during the voyage, causing petrol vapour to enter the hold. At a port, employees of the defendant had to move some of the cargo, and used heavy planks for that purpose. Due to the negligence of the employees, one of the planks fell down, causing a spark that led to a fire that destroyed the entire ship. The plaintiffs claimed for the value of the ship.<sup>40</sup> It was accepted that the possibility that a falling plank may cause a fire was not foreseeable. Nonetheless, the defendant was liable to pay damages amounting to the value of the ship. This was because, according to the court:

“[T]he falling of the plank was due to the negligence of the defendants’ servants. The fire appears to me to have been directly caused by the falling of the plank. Under these

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<sup>39</sup> 983-984.

<sup>40</sup> *In re Arbitration between Polemis and another and Furness, Withy and Co. Ltd* [1921] 3 K.B. 560 560.

circumstances I consider that it is immaterial that the causing of the spark by the falling of the plank could not reasonably have been anticipated.”<sup>41</sup>

This idea - that once there has been some breach of duty, a defendant would be liable for all direct consequences arising out of his conduct, regardless of whether it was foreseeable - was subsequently confirmed.<sup>42</sup>

The rule seems to cast the net of liability very wide. The rule is also vague – with no clearly defined method for determining the extent of “directness” between cause and consequence. It is arguably for these reasons that subsequent case law on the issue introduced certain limits on the application of the direct consequences theory. Subsequent to *Polemis*, the theory was honed, for example, to only apply “to specific interests of the plaintiff towards which the tort has been committed”.<sup>43</sup>

Another example where courts limited the application of the direct consequences theory can be seen in the case of *Liesbosch Dredger v SS Edison*.<sup>44</sup> In this case, a ship negligently collided with and sunk a dredger which was at the time performing in terms of a profitable contract. The owners of the dredger were unable to purchase a new one and therefore suffered financial loss because of their inability to perform in terms of the contract. In this case the court held that such loss of profits, although a direct consequence of the negligent collision, could not be claimed because it was not a direct “physical consequence”.<sup>45</sup> Later case law explained this decision by saying that the loss of profit was not recoverable because it was not part of the interests of the plaintiff against which the tort was committed.<sup>46</sup> Both of these interpretations serve as examples of how the practical effects of the direct consequences theory were limited. For this reason it has been described as theory that was of more academic than practical significance.<sup>47</sup>

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<sup>41</sup> 571.

<sup>42</sup> *Thorogood v Van den Berghs & Jurgens, Ltd* [1951] 2 K.B. 537.

<sup>43</sup> *Bourhill v Young* [1943] A.C. 92 110.

<sup>44</sup> [1933] A.C. 449.

<sup>45</sup> 459.

<sup>46</sup> McKerron *Law of Delict* 127.

<sup>47</sup> Goodhart *Va L Rev* 1967 862.

Exactly forty years after the *Polemis* decision, the Privy Council expressly rejected the direct consequences theory, ending its short and contentious role in English law. This was done in the decision of *Overseas Tankship (U.K.) Ltd v Morts Dock & Engineering Co, Ltd* (“*The Wagon Mound*”),<sup>48</sup> which concerned facts remarkably similar to those in *Polemis*. The court based its rejection of the direct consequences theory on three considerations.<sup>49</sup> First, the *Polemis* decision was not a correct interpretation of the authority it relied on.<sup>50</sup> Secondly it was held not to be in the interest of justice for a person to be liable for consequences which he could not reasonably have foreseen.<sup>51</sup> The third and arguably most important reason for the court’s rejection of the direct consequences rule was the court’s criticism of its logic. The court stated:

“If, as admittedly it is, B’s liability depends on the reasonable foreseeability of consequent damage, how is that to be determined except by foreseeability of the damage which in fact happened – the damage in suit? And, if that damage is unforeseeable so as to displace liability at large how can the liability be restored so as to make compensation payable?”<sup>52</sup>

In essence, the court argued that a defendant cannot be held liable for unforeseeable losses. The court’s argument is applicable to tort cases where negligence has to be determined with reference to the foresight of a reasonable man. If it cannot be reasonably expected that a defendant should have foreseen harm, he will not have been negligent. If he was not negligent in relation to the harm that he has caused, he cannot then be liable for those damages simply because it is a direct consequence of his action.

As a result, the direct consequences test was rejected and replaced by a “reasonable foreseeability” test for remoteness. As we can see, however, the core of the debate and the criticism of the *Polemis* test focuses on the applicability of the direct consequences theory in the law of tort. The detail of the debate around the issue has not been addressed because it falls outside of the scope of this research. The next

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<sup>48</sup> [1961] 1 All E.R. 404.

<sup>49</sup> RG McKerron “Foreseeability is All: A Critical Note on *The Wagon Mound*” (1961) 78 SALJ 282 284.

<sup>50</sup> *Overseas Tankship (U.K.) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound)* [1961] 1 All E.R. 404 416.

<sup>51</sup> 413.

<sup>52</sup> 425.

section will examine the applicability of the direct consequences theory in the English law of contract.

### 3 2 3 The direct consequences theory in the English law of contract

Despite the issue being argued at length,<sup>53</sup> there seems to have been no consensus as to whether the direct consequences theory had application in contract cases. Even in the *Wagon Mound* decision, where the direct consequences theory was ultimately rejected, it remained unclear whether the theory was applicable in cases of breach of contract.<sup>54</sup>

Lord Wright, who argued on behalf of the appellants in *Polemis* where the theory was initially adopted, stated that the direct consequences theory was applicable in both contract and tort.<sup>55</sup> This was also the opinion of Lord Porter<sup>56</sup> and has been supported with reference to dicta made by several judges.<sup>57</sup> Additionally, authors have argued that the direct consequences theory has to be applicable in English contract law because the *Weld-Blundell v Stephens*<sup>58</sup> decision, which concerned contractual damages, relied on the theory. This position has been heavily criticised, however.

Most importantly, it is argued that the *Polemis* case never mentioned *Hadley v Baxendale* (“*Hadley*”).<sup>59</sup> The court could therefore not have intended to change the law remoteness in contract so clearly established in *Hadley*. Decisions about remoteness in contract subsequent to *Polemis* continued to rely on *Hadley* and the reasonable contemplation test without much reference to the direct consequences approach as set out in *Polemis*.<sup>60</sup> In an attempt to avoid this criticism, some authors

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<sup>53</sup> See for instance Wright “Re *Polemis*” (1951) 14 *MLR* 393 395; Goodhart 1952 *LQR* 515-517.

<sup>54</sup> *Overseas Tankship (U.K.) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound)* [1961] 1 All E.R. 404 413.

<sup>55</sup> Wright 1951 *MLR* 396.

<sup>56</sup> SL Porter “The Measure of Damages in Contract and Tort” (1934) 5 *Cambridge L.J.* 176 186.

<sup>57</sup> Goodhart 1952 *LQR* 519. He cites WTS Stallybrass & JW Salmond *Salmond's Law of Torts – A Treatise on the English Law of Liability for Civil Injuries* 10 ed (1945) 155.

<sup>58</sup> [1920] A.C. 956.

<sup>59</sup> [1854] 9 Ex. 341.

<sup>60</sup> Goodhart 1952 *LQR* 522.

have argued that the *Hadley* and *Polemis* tests imply the same thing: that “natural” consequences will be “direct”.<sup>61</sup>

This seems like an attempted reconciliation which would render both terms meaningless. It is clear that “direct” as used by the court in *Polemis* includes even consequences that cannot be anticipated. If we are to argue that such consequences are also “natural” within the meaning of the first limb in *Hadley*, that would imply that the reasonable contemplation test deems unanticipated consequences to have been contemplated. It is therefore doubtful if any attempt at reconciling the reasonable contemplation test of *Hadley* and the direct consequences test of *Polemis* can be sensible.

The direct consequences test as used in English law created much uncertainty – both with regard to the practical application of the test and its theoretical basis. This is especially true in the light of the way in which it seems to have contradicted the test set out in *Hadley* without ever explicitly intending to do so.

As will be seen, regardless of this uncertainty, the term “direct consequences” has been used in South African law in the context of remoteness of contractual damages. What exactly is meant by the term, and to what extent – if at all – the thinking around direct consequences in England has shaped South African terminology is discussed in the next section.

### **3 3 The meaning of direct consequences in South African law**

#### **3 3 1 The direct consequences theory**

In South African law, the direct consequences theory as described above has been applied in isolated instances only.<sup>62</sup> For example, in *Frenkel & Co v Cadle* (“*Frenkel*”)<sup>63</sup> the court rejected the foreseeability approach in favour of the direct consequences theory:

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<sup>61</sup> JW Salmond & WTS Stallybrass *Salmond’s Law of Torts – A Treatise on the English Law of Liability for Civil Injuries* 10 ed (1945) 156.

<sup>62</sup> Neethling et al *Delict* 193.

<sup>63</sup> 1915 NPD 173.

“It is quite immaterial whether a result was one which the defendant could reasonably be expected to have foreseen or not, if it is the direct result of his neglect he is liable.”<sup>64</sup>

This case was again referred to in *Alston and Another v Marine & Trade Insurance Co Ltd* (“*Alston*”),<sup>65</sup> where the court favoured an approach to the issue of remoteness closely resembling the direct consequences approach.<sup>66</sup> However, both the *Frenkel* and *Alston* cases dealt with liability for damages in the context of the law of delict. This does not mean that the direct consequences theory is applicable to remoteness in the South African law of contractual damages.

It has been argued convincingly that, given the fundamentally different natures of obligations arising out of contract and delict, rules of remoteness used in one field cannot be transposed to the other.<sup>67</sup> Especially the fact that contractual duties are voluntarily undertaken suggests foreseeability as a more logical approach than that of direct consequences in the law of contract. When contracting, parties decide the scope of their respective obligations amongst themselves. The nature of the obligations and risks they undertake is arguably determined by what parties are able to take into account when contracting. For that reason, it would seem more sensible to limit the consequences of breach to those that parties were reasonably able to consider when contracting. At least, that seems preferable to determining the consequences for breach of an obligation by examining the directness of the causal relationship between breach and harm, without regard for the context within which the breached contractual obligation was (voluntarily) undertaken originally.<sup>68</sup>

Even if this is not the case, and the acceptance of the traditional direct consequences theory by our courts also applies to our law of contract, the decisions mentioned above have been subject to much criticism<sup>69</sup> and it is fairly settled that the direct consequences theory has never been explicitly accepted by the Supreme Court of

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<sup>64</sup> 186.

<sup>65</sup> 1964 4 SA 112 (W).

<sup>66</sup> 115G-116H.

<sup>67</sup> McKerron 1961 SALJ 288.

<sup>68</sup> Goodhart 1952 LQR 517-519; HJ Erasmus & JJ Gauntlett “Damages” in WA Joubert, JA Ferris & LTC Harms (eds) *LAWSA* 7 2 ed (1995) paras 33-34; SL Porter “The Measure of Damages in Contract and Tort” (1934) 5 *Cambridge L.J.* 185; McKerron 1961 SALJ 288; McKerron *The Law of Delict* 169.

<sup>69</sup> Jansen van Rensburg *Juridiese Kousaliteit* 220-224.



Appeal in South Africa.<sup>70</sup> The direct consequences theory as understood in English law is therefore not part of our current approach to remoteness.

### 3 3 2 Other uses of the term “direct consequences”

Although the direct consequences theory has never been endorsed in the South African law of contract, judgments have referred to the concept of “direct consequences” in decisions about remoteness of contractual damages.<sup>71</sup> It is possible to identify two contexts within which it is used. The first context is where the term “direct” consequences is mentioned with reference to Pothier. Here, an interpretation of Pothier’s work would suggest that the term “direct consequences” refers to something other than “foreseeable consequences”. The second context is where courts seem to suggest that the two terms have the same meaning.

First, as indicated in the previous chapter, the rules of remoteness that are currently used by South African courts were directly and indirectly influenced by the writings of Pothier.<sup>72</sup> He stated that a defendant who intentionally breaches a contract will be liable not only for foreseeable consequences, but also direct consequences.<sup>73</sup> The logic behind this is that a defendant who intentionally breaches a contract should face wider liability than one who did not. It is clear that within this rule, harm that is the “direct consequence” of a breach will be a wider concept than harm that was foreseeable. The implication is therefore that “direct” consequences must be taken to mean something other than “foreseeable” consequences.

However, the test for when damage is “direct” is unclear, also in modern French law.<sup>74</sup> French courts formulate their approach to directness in reference to the examples

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<sup>70</sup> Burchell *Principles of Delict* 120.

<sup>71</sup> *Emslie v African Merchants Ltd* 1908 22 EDC 82 90; *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22; *Natal Shipping & Trading Co Ltd v African Madagascar Agencies Ltd* 1921 TPD 530; *Marais v Commercial General Agency Ltd* 1922 TPD 440; *Bower v Sparks, Young and Farmers’ Meat Industries Ltd* 1936 NPD 1 17; *Administrator Natal v Edouard* 1990 3 SA 581 (A) 558; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 688A; *Freddy Hirsch Group (Pty) Ltd v Chickenland (Pty) Ltd* 2011 (4) SA 276 (SCA) 291.

<sup>72</sup> Ch 2 (2 5).

<sup>73</sup> WD Evans *RJ Pothier: A Treatise on the Law of Obligations – Translated from French* (1806) paras 161-166.

<sup>74</sup> Nicholas *French Law of Contract* 230.

used by Pothier.<sup>75</sup> This was discussed in chapter two. A brief summary will be provided here.

Pothier uses the example of a man who fraudulently sells a cow with an infectious disease to a farmer. He then considers three different losses: the loss of other animals that contracted the disease, the loss of profits as a result of the fact that the farmer could not cultivate his land, and the farmer's loss of his land because it was seized by creditors.<sup>76</sup>

Pothier holds that the loss of the animals that contracted the disease is a direct consequence of the breach. He employs no specific test for directness – he merely states that it is the fraud of the seller that causes the loss.<sup>77</sup> Arguably, he considers the loss of the animals to be a direct consequence of the breach simply because of a close causal connection. There is, however, no indication of how one can objectively determine whether or not a consequence is sufficiently closely connected to a particular breach.

Pothier argues further that the loss of land is an indirect consequence because it has no “necessary relation” to the breach by the seller:

“[T]he seller will not be liable for the damage which I suffer from the seizure of my effects; this damage is only a very remote and indirect consequence of his fraud, and has not any necessary relation to it...”<sup>78</sup>

Finally, he refers to the problematic issue of the losses caused by the farmer's inability to cultivate his land. In this case he states that such losses are not “an absolutely necessary”<sup>79</sup> consequence of the breach and comes to the conclusion that the farmer must be compensated only in part for these losses.

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<sup>75</sup> Evans *RJ Pothier: A Treatise on the Law of Obligations or Contracts – Translated from the French* (1853) para 166-167. H Beale, A Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Texts on Contract Law* 2 ed (2010) 1004 indicates that it is quoted in Maularie & Aynès *Les obligations* 9 ed (1998) 838; Nicholas *French Law of Contract* 229.

<sup>76</sup> Para 166-167 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 187.

<sup>77</sup> Para 166.

<sup>78</sup> Para 167 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 187.

<sup>79</sup> Para 167 as translated in Evans *Pothier: A Treatise on the Law of Obligations* 187.

It seems therefore that the best possible explanation of the word “direct” in the context of Pothier’s work would be that direct consequences are those that are in a “necessary” relation to the breach of contract. The use of the word “necessary” does not really make the concept easier to understand. What is clear from Pothier’s work, however, is that “direct consequences” is not synonymous with “foreseeable consequences”.

It might therefore be possible to argue that “direct consequences” is used by our courts to convey something different from “foreseeable consequences”. This would still not provide a clear understanding of what exactly the term “direct consequences” means in the context of our law of contract. It seems unlikely that the references to direct consequences by our courts refer to the theory of direct consequences as discussed in the context of English law. When our courts have referred to the directness of a consequence in the context of remoteness in contract, it was never with reference to authority pertaining to the test as set out in section 2 above. Rather, courts refer to Pothier, Voet, and *Hadley*.<sup>80</sup> The test as set out in section 2 has also not been applied by our courts in any contract cases.

Arguably, the term is also not used in a way similar to that of French law where the intention of the defendant is relevant to determine whether he would be liable for direct consequences. In the French approach, direct consequences are wider than foreseeable consequences – and that broader liability is justified with reference to the fact that the breach was committed intentionally. It seems unlikely that the wider meaning of the term “direct consequences” in French law can be applied in our law without such an underlying reason for it.

The implication of an interpretation of “direct consequences” as distinguishable from “foreseeable consequences” is therefore uncertain. It might not be the correct interpretation, however. There are many other writers who argue that our courts use the word “direct” simply as a synonym for “natural” (and therefore reasonably foreseeable) consequences. This is the second context in which the term is used.

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<sup>80</sup> See, for instance: *Emslie v African Merchants Ltd* 1908 22 EDC 82 91; *Victoria Falls & Transvaal Power Co Ltd V Consolidated Langlaagte Mines Ltd* 1915 AD 1 22; *Bower v Sparks, Young and Farmer’s Meat Industries* 1936 NPD 1 13.

Under this interpretation, harm suffered will be considered to be the direct consequence of a breach if it is the immediate or natural consequence thereof.<sup>81</sup> This seems in line with the use of the word “direct” in case law - most notably *Emslie v African Merchants*<sup>82</sup> where the court held that for damage to be recoverable a plaintiff must prove:

“[T]hat the damages he claims... are the direct, proximate and natural result of the breach of contract.”<sup>83</sup>

It has therefore been argued, both by South African and English authors, that the terms “natural” and “direct” are simply used to convey the idea that there exists a reasonable connection between the breach and the harm suffered, with the effect that damage is deemed to have been foreseeable by law.<sup>84</sup>

It can therefore be concluded that the references to the term “direct consequences” do not refer to a test in addition to the contemplation and convention tests. Our courts’ use of the word can perhaps be criticised as unnecessary and confusing. It would seem that the reference to direct consequences in the context of remoteness does not convey any addition or expansion of the foreseeability-based approach that we follow.

### 3 4 Evaluation

In the light of the discussion above, it can be accepted that the direct consequences theory is not currently used to determine remoteness of contractual damages in South African law. References to “direct consequences” can arguably be taken to simply mean “natural consequences”. The purpose of this study is not only to clarify our current position, however, but also to highlight possible insights to be gained from alternative theories of remoteness. The final section of this chapter seeks to evaluate what the direct consequences theory might contribute when considering possible future developments of our approach to remoteness in contract.

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<sup>81</sup> HJ Erasmus & JJ Gauntlett “Damages” in *LAWSA* 7 para 14.

<sup>82</sup> 1908 EDC 82.

<sup>83</sup> 90-91.

<sup>84</sup> McKerron *The Law of Delict* 127.

In essence, when dealing with the issue of remoteness, courts determine whether there is sufficient justification to shift responsibility for losses from the person who suffered it to the person who caused it.<sup>85</sup> This is ultimately an issue of policy and not logic, as Boberg states:

“The merit of a test for remoteness depends, not on logic or justice, but on its ability to yield the results deemed desirable by other criteria. To let a predilection for a particular test of remoteness persuade us that its results are desirable is to abdicate responsibility for a policy decision, in effect allowing the tail to wag the dog.”<sup>86</sup>

An evaluation of the merits of the direct consequences theory could contribute to our understanding of the “criteria” by which a remoteness decision is deemed desirable. Even if it seems clear that “direct consequences” as currently referred to in our law of contract is an unclear and therefore arguably unhelpful concept,<sup>87</sup> there are some noteworthy elements of the theory that might provide valuable insights.

The first aspect of the theory that has been highlighted as positive is that it leaves the question of remoteness quite open to the court’s discretion. The direct consequences theory focusses on the causal relationship between the breach and the harm suffered. The manner in which this is determined is largely dependent on the facts and circumstances of each case.<sup>88</sup> This has been said to provide the advantage of more flexibility.<sup>89</sup> McKerron argues that, because remoteness will always be a question of degree, it can be better addressed by such a flexible approach than by the application of one “simple abstract principle”.<sup>90</sup>

The second advantage of the direct consequences approach is that, according to some writers, it leads to more fair results. It is argued that, whereas foreseeability places an undue focus on what the defendant could foresee, directness places more focus on losses suffered by the plaintiff.<sup>91</sup> In other words, when we consider

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<sup>85</sup> JC Van Der Walt “Vonnisbespreking: *Van den Bergh v Parity Insurance Co Ltd and Another* 1966 2 SA 621 (W)” (1966) 29 *THRHR* 244 246.

<sup>86</sup> Boberg *The Law of Delict* I 442.

<sup>87</sup> Jansen van Rensburg *Juridiese Kousaliteit* 223-224.

<sup>88</sup> McKerron *The Law of Delict* 123-126.

<sup>89</sup> Burchell *Principles of Delict* 119; Boberg *The Law of Delict* I 442.

<sup>90</sup> McKerron *The Law of Delict* 123.

<sup>91</sup> Van Der Walt 1966 *THRHR* 246.

remoteness in contract as a policy decision, the key difference between the foreseeability and direct consequences approaches seems to lie in which party's interests forms the primary focus. Should the measure or extent of damages be determined with reference to losses actually suffered by the plaintiff, or with reference to the value that a reasonable person in the position of the defendant would have expected it to be?<sup>92</sup>

If we follow the first approach, the main method of limiting damages would be with reference to the quality of the causal relationship between breach and losses actually suffered: as long as harm can be said to result directly from the breach, it should be recoverable. If we follow the second approach, our emphasis would be on what the defendant could have foreseen or expected to be liable for upon breach – only damage that could have been contemplated should be recovered. The first seems to be the emphasis of the direct consequences approach, the second that of the foreseeability approach.<sup>93</sup>

It is not apparent, however, that a focus on the interest of the plaintiff in the context of contractual damages is appropriate. It can be argued that exactly because of the voluntary nature of contractual obligations one should be more sensitive to which risks the defendant could be presumed to have submitted to. Regardless, the somewhat different emphasis of the direct consequences approach could be informative in formulating an approach to remoteness.

Apart from these two points, the criticism against the direct consequences approach strongly outweighs any advantages that it might hold. The point of criticism that arguably carries the most weight is simply that the use of "directness" as a criterion adds nothing new to the remoteness inquiry. It is argued that the test is unable to satisfactorily distinguish between direct and indirect consequences.<sup>94</sup> This is exactly because the conceptualisation of what would constitute an "independent" or "intervening" cause is so fluid. A consequence is "direct" if there has been no new or

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<sup>92</sup> JF Wilson & CJ Slade "A Re-Examination of Remoteness" (1952) *MLR* 458 462.

<sup>93</sup> Van Der Walt 1966 *THRHR* 246.

<sup>94</sup> Prosser "Palsgraf Revisited" in *Selected Topics on the Law of Tort* 230.

intervening (and independent) cause.<sup>95</sup> But concluding that a cause is independent cannot be done without considering other factors – such as foreseeability.

De Wet points out that proponents of the direct consequences theory include foreseeable consequences in those that are direct even if that is sometimes at the cost of logical consistency.<sup>96</sup> As an example he mentions harm caused by the foreseeable action of a third party. Such consequences cannot really be considered direct. But the foreseeable action of the third party is in this instance not considered to be an independent intervening cause<sup>97</sup> – illustrating how the concept of directness does not really help to draw a line between damages that can be recovered and damages that are too remote. The result would be that the direct consequences theory casts the net of liability too wide.<sup>98</sup>

The core of the criticism against the theory is, therefore, simply that it does not contribute to solving issues of remoteness.<sup>99</sup> It merely moves the question back one step. Instead of asking whether or not an action is the direct cause of harm suffered, one must now inquire if something was an intervening cause or not. The theory does not in itself really contribute to a method for answering this question. Rather, it seems to ask only if a connection between breach and harm is reasonable enough to impose liability.<sup>100</sup> In the words of Jansen van Rensburg, the only real advantage of the direct consequences theory seems to be that it is vague and therefore flexible.<sup>101</sup>

### 3 5 Conclusion

Given the limitations of the direct consequences theory discussed above, there does not seem to be an argument for the employment of the direct consequences theory in South African contract law. It is a theory that does not solve the uncertainty that we currently face, and one that has many problems of its own.

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<sup>95</sup> McKerron *The Law of Delict* 123.

<sup>96</sup> De Wet 1941 *THRHR* 138.

<sup>97</sup> McKerron *The Law of Delict* 125; Boberg *The Law of Delict I* 441.

<sup>98</sup> De Wet & Van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg I* 228.

<sup>99</sup> Van der Walt 1996 *THRHR* 246.

<sup>100</sup> McKerron *The Law of Delict* 127.

<sup>101</sup> Jansen van Rensburg *Juridiese Kousaliteit* 223.

However, there are two aspects of the direct consequences theory that might be worth mentioning with reference to future developments of our approach to remoteness in contract.

First, we have seen how most of the proponents of the direct consequences theory advocate a flexible approach to remoteness. The policy-based nature of the inquiry into remoteness has been highlighted in the overview of the direct consequences theory. This has led to the suggestion that remoteness inquiries should not be fixated on one logical principle that is unable to accommodate the facts and circumstances of a particular case. This insight will be discussed in detail in Chapter 6 of this study.

In this regard it might be appropriate to caution against formulating one logically principled test for remoteness at the cost of flexibility. This caution seems to be in line with our Appellate Division's recent suggestion that our current foreseeability approach to remoteness in contract should be replaced by a flexible test such as the one we have in the law of delict.<sup>102</sup> When evaluating that suggestion later in this research, it will be with due regard to the many authors who have argued in favour of a test for remoteness that is flexible in nature.

The second aspect of the direct consequences theory that might be valuable to the further analysis of our approach is its emphasis on the plaintiff's interest. The entire approach has reminded us that, when all is said and done, the plaintiff has suffered harm. All or most of that harm was factually caused by the defendant's breach. The thinking behind the direct consequences theory warns against placing too high a burden on the plaintiff through emphasis on the defendant's interests. As we have seen, this argument has to take account of the contractual nature of the relationship between plaintiff and defendant. It is therefore by no means a blanket statement, but rather a reminder that a test of remoteness implicitly makes certain assumptions about the relative importance of parties' interests.

Although these are valuable insights to consider when discussing possible ways forward, it clearly does not provide a distinct solution or possible alternative to our current approach to remoteness in contract and the criticism it faces. For a better

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<sup>102</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 2001 4 SA 551 (SCA) 582F-583C.



understanding of the issue and our possible alternatives, we need to turn to other theories of remoteness. The next chapter will explore a second possible theory of remoteness: the theory of adequate causation.



## CHAPTER 4: THE ADEQUATE CAUSE THEORY

### 4 1 Introduction

As seen in the previous chapter, the theory of direct consequences does not necessarily provide us with a viable alternative to, or better understanding of, the limitation of contractual damages in South Africa. The second theory mentioned as a possible basis for the limitation of contractual damages is that of adequate causation.<sup>1</sup> This theory underlies the approach to remoteness of contractual damages in German law.<sup>2</sup>

The adequate cause theory is based on the premise that liability for contractual damages should primarily be limited with reference to causation.<sup>3</sup> This chapter focusses on German law in particular, because it was German scholars who made the most important contribution to the development of this theory.<sup>4</sup> Emphasis will be placed on the content of the theory and its refinement in the *Schutzzwecklehre*. The details of its historical development and application by German courts fall outside of the scope of this chapter, except where they contribute to an understanding of the adequate cause theory.

As seen previously,<sup>5</sup> the South African approach to limiting contractual damages is based upon the principle of foreseeability. The contemplation principle aims to determine which harm a defendant foresaw, or could reasonably be expected to have foreseen.

It has been argued by some authors that German law also incorporates a foreseeability principle in its rules of remoteness through § 254 BGB. This provision of the German Civil Code or *Bürgerliches Gesetzbuch* governs cases where the presence of fault or negligence on the part of the injured party results in a decrease in the amount of damages that he can claim. It provides that a plaintiff's claim would be

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<sup>1</sup> GF Lubbe & CM Murray Farlam & Hathaway: *Contract – Cases, Materials and Commentary* 3 ed (1988) 624.

<sup>2</sup> R Young *English, French and German Comparative Law* (1998) 302.

<sup>3</sup> GH Treitel *Remedies for Breach of Contract – A Comparative Account* (1988) 162.

<sup>4</sup> HLA Hart & T Honoré *Causation in the Law* 2 ed (1985) 431.

<sup>5</sup> Ch 2.

reduced in instances where he omitted to inform the defendant of the possibility of unusually extensive damage – damage of which the defendant was neither aware nor “should have known” about.<sup>6</sup> The effect of this provision will often be similar to that of the foreseeability theory.<sup>7</sup>

However, despite the provision in § 254 BGB, German law rejects foreseeability as the primary basis for the limitation of liability for contractual damages.<sup>8</sup> It is safe to say that German law, unlike South African law, principally relies on adequate causation and not foreseeability when approaching the issue of remoteness in contract.<sup>9</sup> For purposes of this chapter, therefore, the possibility of a foreseeability principle incorporated into § 254 BGB will not be discussed further. The links that do exist between the foreseeability theory in general and the adequate cause theory will be explored later in this chapter.<sup>10</sup>

This chapter commences with a brief overview of the development and current operation of the adequate cause theory as well as its refinement in the *Schutzzwecklehre*. This will be followed by a comparison between the adequate cause approach and the foreseeability approach that is applied in South Africa. Finally, the chapter concludes with an evaluative discussion of the possible implications of that comparison.

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<sup>6</sup> IS Forrester, SL Goren & H Ilgen *The German Civil Code* (1975) 42.

<sup>7</sup> J Gordley “Responsibility in Crime, Tort and Contract for the Unforeseeable Consequences of an Intentional Wrong: A Once and Future Rule?” in P Cane & J Stapleton (eds) *The Law of Obligations - Essays in Honour of John Fleming* (1998) 175 203.

<sup>8</sup> GH Treitel *Remedies for Breach of Contract* 162, citing L Enneccerus & H Lehmann *Recht der Schuldverhältnisse* 15 ed (1958) 73 and K Larenz *Lehrbuch des Schuldrechts I* 14 ed (1987) 493; A Komarov “The Limitation of Contract Damages in Domestic Legal Systems and International Instruments” in D Saidov & R Cunningham (eds) *Contract Damages – Domestic and International Perspectives* (2008) 245 253; O Kahn-Freund “Remoteness of Damage in German law” (1934) 50 *LQR* 512 518; Young *English, French and German Comparative Law* 442.

<sup>9</sup> BS Markesinis *A Comparative Introduction to the German Law of Tort* 3 ed (1994) 99; GH Treitel “Substitutionary Relief in Money” in AT von Mehren (ed) *International Encyclopedia of Comparative Law VII part 2* (1986) 66.

<sup>10</sup> See 4 below.

## 4 2 The adequate cause theory

In very broad terms it can be said that the adequate cause theory uses community standards of fairness and justice to determine whether or not a sufficiently strong causal nexus exists between a breach of contract and the harm suffered as a consequence of that breach.<sup>11</sup> If the causal nexus is found to be sufficiently strong, or adequate, liability for damages will be imposed. The existence of a causal nexus is determined by establishing whether or not the breach of contract would have the general tendency, based on human experience and knowledge, to increase the objective probability that the harm in question would occur.<sup>12</sup> These general elements of the adequate cause theory are expressed in a variety of different formulations.

Hart and Honoré argue that the continental approach to causation is more technical than conceptual in nature.<sup>13</sup> Causal principles were initially formulated in a manner that focussed on scientific and philosophically technical principles of probability rather than on common-sense notions about the proximity between two actions in a legal sense. German jurists have applied complex philosophical doctrines such as the works of Kant and Mills to the issue of remoteness – something that has not been seen in common-law works on the issue.<sup>14</sup> This continental emphasis on scientific and technical explanations for causal relationships can also be discerned in the development of the adequate cause theory. It was initially formulated more as a description of causal relationships than a justification for the limitation of liability.<sup>15</sup> This has been contrasted to the common-law approach where we find a stronger emphasis on fairness and common-sense considerations.<sup>16</sup> As we will see later,<sup>17</sup> the common-law approach to legal causation always focussed primarily on underlying policy reasons for limiting liability. By contrast, early formulations of the adequate cause

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<sup>11</sup> AT von Mehren & JR Gordley *An Introduction to the Comparative Study of Law - The Civil Law System* 2 ed (1977) 1115.

<sup>12</sup> BS Markesinis, A Johnston & H Unberath *The German Law of Torts – A Comparative Treatise* 2 ed (2006) 106-107.

<sup>13</sup> Hart & Honoré *Causation in the Law* 432.

<sup>14</sup> 432, citing Leonhard *Die Kausalität als Erklärung durch Ergänzung* (1946) 26, 31.

<sup>15</sup> Hart & Honoré *Causation in the Law* 432.

<sup>16</sup> WF Ebke & MW Finkin *Introduction to German Law* (1996) 206.

<sup>17</sup> Ch 5.

theory were preoccupied with explaining factual patterns. It was only later that policy considerations came to be incorporated into the theory.

Below, a brief historical overview of these technical origins of the adequate cause theory will be provided. This will be followed by a discussion of the theory's development into a more normative and policy-driven approach. The adequate cause theory was developed as a refinement of the equivalence theory. Fundamental to the equivalence theory, and therefore also to our understanding of the adequate cause theory, is the distinction between conditions and causes. This will be explained in a discussion of the equivalence theory in section 2 1 1. This is followed by a description of the subsequent development of the adequate cause theory. Finally, an overview of the operation of the adequate cause theory as applied today will be provided in section 2 1 3.

The purpose this historical overview is to indicate that there has been a substantial shift in the German approach to the adequate cause test. It is now regarded not as a test for scientific or empirical causation but rather as a framework within which to make a normative judgment about the limits of liability.<sup>18</sup> In keeping with this more normative, policy-centred approach to the limitation of contractual damages, and in an attempt to overcome earlier problems with the adequate cause test, German law has developed the *Schutzzwecklehre* or “protective purpose theory”. The theory will be discussed in section 3.

#### 4 2 1 Historical overview

##### 4 2 1 1 *The theory of equivalent causation and the notion of conditions*

The German theory of conditions has its origin in the doctrine of *versari in re illicita*:<sup>19</sup> a person who acts illegally will be responsible for all the consequences of his actions that would not have occurred if it were not for his action.<sup>20</sup> This idea was used to formulate the theory of conditions as set out by Glaser:

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<sup>18</sup> Hart & Honoré *Causation in the Law* 474-476, citing G Berbert “Die Leerformel der Adäquanz” (1969) *AcP* 169 421.

<sup>19</sup> Hart & Honoré *Causation in the Law* 442.

<sup>20</sup> JM Burchell & J Milton *Principles of Criminal Law* 3 ed (2005) 544.

“[i]f one attempts wholly to eliminate in thought the alleged author [of the act] from the sum of the events in question and it then appears that nevertheless the sequence of intermediate causes remains the same, it is clear that the act and its consequence cannot be referred to him... [B]ut if it appears that, once the person in question is eliminated in thought from the scene, the consequences cannot come about, or that they can come about only in a completely different way, then one is fully justified in attributing the consequence to him and explaining it as the effect of his activity.”<sup>21</sup>

Every event that is a *sine qua non* for a consequence is therefore described as its cause. This seems to resemble the basic test for factual causation that is also familiar in the South African law of contract.<sup>22</sup>

This understanding of the concept of *sine qua non* led to the formulation of the notion of “conditions” amongst German writers. Something would be considered a “condition” of a consequence if it was necessary to bring that consequence about. In other words, conduct is considered to be a condition of a particular consequence if, “once it has been eliminated in thought, the consequence at once falls away”.<sup>23</sup>

It is clear that, for any given consequence, the conditions will be endless – at least where the absence of something is also counted as a condition. For a fire to be started, one condition is the act of lighting that fire. Another condition would be the oxygen in the air. Even further, all negative conditions, whose non-existence make the fire possible, would also be a condition – such as the lack of water where the fire is made.<sup>24</sup>

The equivalence theory held that all conditions of a consequence are equivalent. In other words, all conditions would be equally causally related to a certain consequence – regardless of the relative probabilities with which each condition made the consequence more likely.<sup>25</sup> This idea was concisely formulated by Tarnowski:<sup>26</sup>

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<sup>21</sup> J Glaser *Abhandlungen aus dem Österreichischen Strafrecht* (1858) 298 as translated in Hart & Honore *Causation in the Law* 443.

<sup>22</sup> SWJ van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 360.

<sup>23</sup> RGSt (1932) 181, 184 as translated in Hart & Honore *Causation in the Law* 446.

<sup>24</sup> PK Ryu “Causation in Criminal Law” (1958) 106 *University of Pennsylvania L.R.* 773 782.

<sup>25</sup> T Wagner “Limitations of Damages for Breach of Contract in German and Scots Law” (2014) 10 *Hanse LR* 73 83.

<sup>26</sup> H Tarnowski *Die Systematische Bedeutung der Adäquaten Kausalitätstheorie für den Aufbau des Verbrechensbegriffs* (1927) 257 as translated in Hart & Honore *Causation in the Law* 444.

“The theory of conditions takes as its starting-point the proposition that all conditions of a consequence, which cannot be eliminated in thought without eliminating the consequence also, are equivalent and therefore each single one of these necessary conditions can be regarded as the cause of this consequence.”<sup>27</sup>

He argued that everything without which a particular consequence could not have occurred is to be regarded as a cause of that consequence. This argument therefore held that the relative contribution that different causes made towards a consequence was irrelevant, as were the relative probabilities with which they increased the likelihood of the consequence occurring. To use the example mentioned above, the lack of water where the fire was made and the act of lighting the fire are equivalent causes of the fire.

The theory of equivalent conditions is still widely applied in German criminal law today, but it has been rejected in civil law where the adequate cause theory is accepted.<sup>28</sup> The adequate cause theory still recognises the notion of conditions, however. Everything that is a *sine qua non* for a particular consequence is accepted as a condition. However, the adequate cause theory holds that not all conditions can be regarded as causes – as will be seen below.

#### 4 2 1 2 Development of the adequate cause theory

Von Bar was one of the first scholars to criticise the idea that all conditions can be regarded as equivalent causes of a specific consequence.<sup>29</sup> He argued that, while there are many different conditions that contribute to a particular consequence, not all will be legally relevant. Rather, he said, many conditions are regarded as being regularly present in the normal course of events. Such conditions cannot be causes.<sup>30</sup> He argued that these conditions are presupposed in a causal statement. In other words: if we say that someone lighted a fire, we are assuming that there was no water where the fire was started. The lack of water may be a condition for the fire, but it should not be considered a cause. He therefore concluded that:

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<sup>27</sup> Hart & Honoré *Causation in the Law* 257.

<sup>28</sup> 445.

<sup>29</sup> JC de Wet “Opmerkings oor die Vraagstuk van Veroorsaking” (1941) 5 *THRHR* 126 128.

<sup>30</sup> L von Bar *Die Lehre vom Kausalzusammenhange im Recht, besonders im Strafrecht* (1871) as discussed in Hart & Honoré *Causation in the Law* 466.



“A man is in the legal sense the cause of an occurrence to the extent that he may be regarded as the condition by virtue of which what would otherwise be regarded as the regular course of events in human experience was altered.”<sup>31</sup>

Von Bar therefore argued that there is a normal course of events in general human experience. Although there is an endless amount of conditions that are necessary for a particular consequence to set in, the law is only concerned with those conditions that alter the normal course of events in human experience. These will be considered causes in the legal sense. For a particular event to come about there are therefore endless conditions, but only some of these will be considered causes.

This notion of “normal course of events in human experience” was expanded upon by Von Kries, who formulated the notion of adequate cause. Based on Von Bar’s argument, he argued that “the normal course of events” can be objectively ascertained.<sup>32</sup> He therefore held that a given occurrence will be the adequate cause of a given harm if, (1) it was a *sine qua non* – or a condition – of the harm and (2) it had significantly increased the objective probability of the harm occurring.<sup>33</sup>

The idea of a certain action increasing an objective probability of a consequence is illustrated by Hart and Honoré with reference to a particular example. If we know what proportion of human beings suffer from tuberculosis, and we know that a higher proportion of miners suffer from tuberculosis, we can infer that the objective probability of a miner contracting tuberculosis is higher. Therefore we can say that a man’s act of starting to work as a miner increases the objective probability of him contracting tuberculosis. If he does suffer from tuberculosis and he would not have contracted the disease without working at that mine, we can say that his work there is an adequate cause of his disease.<sup>34</sup>

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<sup>31</sup> L von Bar *Die Lehre vom Kausalzusammenhange im Recht, besonders im Strafrecht* (1871) 11 as translated in Hart & Honoré *Causation in the Law* 466.

<sup>32</sup> Hart and Honoré *Causation in the Law* 467.

<sup>33</sup> 469.

<sup>34</sup> 469.

The adequate cause theory was accepted by the civil senate of the *Reichsgericht* in 1898<sup>35</sup> and it was subsequently confirmed and adapted by several authors.<sup>36</sup> Arguably the most influential formulation of the test<sup>37</sup> was by Traeger in 1904.<sup>38</sup> He held that a condition would legally be considered to be the adequate cause of harm if it had increased the objective probability of that harm by a considerable extent. According to him, whether or not a condition is an adequate cause has to be determined with reference to two things. First, one must take account of all the circumstances that an optimal (or experienced) observer would have been able to notice at the time that the defendant acted. Secondly, one must also take account of all circumstances actually known to the defendant.<sup>39</sup>

#### 4 2 2 The operation of the adequate cause theory

In cases of civil liability, German courts apply the adequate causation test as the accepted measure of remoteness in contract.<sup>40</sup> The initial assumption is that a defendant is liable for all the harm that his breach of contract had caused.<sup>41</sup> However, such liability will only be imposed, if:

“[his breach] was apt to lead to the [harm] which occurred, taking things as they normally happen and ignoring very peculiar and improbable situations which men of the world would not take into account.”<sup>42</sup>

The fact that the court will decide on the causal proximity between breach and harm with reference to some conception of “events as they normally would happen” has some similarities with phrases found in the foreseeability approach – such as “the normal course of events” or “the ordinary course of things”.<sup>43</sup> These possible

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<sup>35</sup> RGZ 42, 291.

<sup>36</sup> See the discussion in De Wet 1941 *THRHR* 128-131 and Hart & Honoré *Causation in the Law* 471-472.

<sup>37</sup> Wagner 2014 *Hanse LR* 83; Hart and Honoré *Causation in the Law* 471.

<sup>38</sup> L Traeger *Der Kausalbegriff im Straf- und Zivilrecht* (1904).

<sup>39</sup> Zweigert & Kötz *An Introduction to Comparative Law II – The Institutions of Private Law (translated from German by T Weir)* (1977) 269.

<sup>40</sup> GH Treitel “Substitutionary Relief in Money” in A Von Mehren (ed) *International Encyclopedia of Comparative Law VII part 2* (1986) 54 66.

<sup>41</sup> 66.

<sup>42</sup> RGZ 158, 38 as quoted in Zweigert & Kötz *An Introduction to Comparative Law II* 269.

<sup>43</sup> GH Treitel *Remedies for Breach of Contract* 164.

similarities will be further explored in section 4. For purposes of this section a few general comments about the operation and subsequent development of the adequate cause theory will be made without reference to its possible correlation with the foreseeability theory.

In deciding whether or not a breach of contract is an adequate cause of harm suffered by the plaintiff, the court does not, as a point of departure, take the subjective state of mind of the defendant into account.<sup>44</sup> What the defendant actually knew will only be relevant in cases where such knowledge implies increased liability. Rather, the court seeks to ascertain whether or not an experienced observer would have considered the breach to be an adequate cause of the harm suffered.<sup>45</sup> To determine this, the experienced observer is deemed to have knowledge of all the circumstances of which a person in the position of the defendant could be expected to have known, as well as all the additional circumstances of which the wrongdoer himself actually knew.<sup>46</sup> This application of the test follows the formulation set out by Traeger.<sup>47</sup> If the defendant knew more than what an optimal observer ought to have known, such knowledge will be taken into account. His subjective lack of knowledge does not limit his liability, however, because the test is primarily objective in nature.

Another noteworthy element of the test in its early formulations is that it is stated in the negative. A defendant is liable for all the consequences of his breach, unless the damage did not occur in the normal course of events according to objective human knowledge and experience.<sup>48</sup> It is therefore of no consequence whether or not the damage could be expected by the defendant to have occurred in the normal course of events. Rather, it is only required that the objective probability of damage of that kind was generally increased by the breach. The impact of the negative formulation of the test is best illustrated with reference to a famous case on the issue.<sup>49</sup>

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<sup>44</sup> Kahn-Freund 1934 *LQR* 516.

<sup>45</sup> K Larenz *Lehrbuch des Schuldrechts I* (1957) 439 as translated in Wagner 2014 *Hanse LR* 84.

<sup>46</sup> BGH 23 Oct. 1951; BGHZ 3, 261 166-167 as cited in Treitel *Remedies for Breach of Contract* 163.

<sup>47</sup> L Traeger *Der Kausalbegriff im Straf- und Zivilrecht* (1904) as discussed in Wagner 2014 *Hanse LR* 84.

<sup>48</sup> Kahn-Freund 1934 *LQR* 518.

<sup>49</sup> RGZ 81 (1913), 359 as discussed in Hart & Honoré *Causation in the Law* 478-480; Kahn-Freund 1934 *LQR* 517-518.

In this case there was a contract to tow two lighters (flat-bottomed barges) from Cuxhaven to Nordenham on 28 October 1909. On that particular day the weather was fine. Despite the owner's objections, however, the contractor did not tow the lighters on that day. Rather, he towed the vessels on 29 October. The weather forecast for that day was also favourable, but during the trip a storm broke out and the lighters were severely damaged as a result.<sup>50</sup> It was held that the delay by the contractor was an adequate cause of the damage. This was because the "objective probability of a consequence of the sort that occurred was generally increased or favoured by the breach".<sup>51</sup> At the end of October, every subsequent day will be less likely to have favourable weather.

Liability for damages would only have been excluded if the damage did not occur in the natural course of things because of the influence of an additional event that had nothing to do with the breach and that could have caused the damage apart from the breach.<sup>52</sup> Another ship crashing into the lighters would have been such an example.

As we can see from this case, the result is that the net cast by the adequate cause theory as originally formulated was quite wide. Over time, we see a move away from a very rational focus on probabilities, to a more normative application of the test. Courts came to consider the policy reasons for imposing or limiting liability rather than simply focussing on probabilistic determinations of causation. This was explicitly acknowledged by the *Bundesgerichtshof* in 1951 in the important *Edelweiss*<sup>53</sup> decision.<sup>54</sup> In this decision the court confirmed the adequate cause theory as formulated by Traeger, but stated that that it was not a formula that should be rigidly applied.<sup>55</sup> In the court's words:

"only if courts remain conscious of the fact that the question is not really one of causation but of fixing the limits within which the author of a condition can fairly be made liable for its

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<sup>50</sup> Hart & Honoré *Causation in the Law* 478.

<sup>51</sup> RGZ 81 (1913), 359 363 as quoted in Hart & Honoré *Causation in the Law* 478.

<sup>52</sup> Kahn-Freund 1934 *LQR* 519.

<sup>53</sup> BGHZ 3 (1951), 261.

<sup>54</sup> Hart & Honoré *Causation in the Law* 475.

<sup>55</sup> 474.

consequences... can they avoid schematising the adequate cause formula and guarantee correct results.”<sup>56</sup>

Hart and Honoré argue that this decision should be interpreted as an invitation to courts to use the adequate cause theory as a guide to the application of common-sense principles.<sup>57</sup> German courts have subsequently confirmed the importance of common sense and fairness when determining the limits of liability.<sup>58</sup> The issue of legal causation is seen as “the discovery of a corrective device which can limit the purely logical consequences of causation in the interest of equity”.<sup>59</sup>

It can be said, therefore, that the adequate cause theory has developed from a very technical and probability-based analysis into more of a framework within which the equitable limits of liability should be determined. This shift in the application of the test has had the consequence of the test itself becoming more flexible and discretionary – and also, arguably, vague.<sup>60</sup>

The adequate cause test as understood and developed above cannot be applied mechanically and relies to a large extent on the discretion of the judge.<sup>61</sup> In the end, many applications of the adequate cause test seem more in line with common-sense than notions of causation.<sup>62</sup> A good example is a case in which a storehouse keeper had contracted to store goods and keep them “absolutely dry”.<sup>63</sup> He had stored the goods on the ground level of a shed. When a nearby dam burst and the shed was flooded, the goods were damaged. The court held that the storage of the goods on the ground floor did increase the risk of humidity and damage to the goods – and could therefore be considered a breach of contract. However, the court found that the damage suffered was not caused by the breach, and that the bursting of the dam had

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<sup>56</sup> BGHZ 3 (1951), 261, 267 as translated in Hart & Honoré *Causation in the Law* 475.

<sup>57</sup> Hart & Honoré *Causation in the Law* 475.

<sup>58</sup> BGHZ 18, 286 288 as cited in Zweigert & Kötz *An Introduction to Comparative Law II* 269; BGHZ 30, 154, 157 as cited in Ebke & Finkin *Introduction to German Law* 206.

<sup>59</sup> BGHZ 30, 154, 157; BGHZ 3, 261, 267 as translated in Markesinis *A Comparative Introduction to the German Law of Torts* 101.

<sup>60</sup> Markesinis *A Comparative Introduction to the German Law of Torts* 101.

<sup>61</sup> Treitel *Remedies for Breach of Contract* 163.

<sup>62</sup> Hart & Honoré *Causation in the Law* 491.

<sup>63</sup> RGZ 42, 291 as cited in Kahn-Freund 1934 *LQR* 518-519.

been an independent event. In the court's words, the damage "did not lie in the direction of the obligation".<sup>64</sup> This conclusion does seem logical and in line with a common-sense approach to causation, but a strict application of the adequate cause theory would not necessarily support the same conclusion. The breach that occurred by placing the goods on the ground floor of the shed could arguably be considered to be the type of event that would, according to objective standards, increase the risk of the type of harm that occurred.

As Hart and Honoré point out:

"[I]n this way the courts preserve a certain flexibility of approach and are able to achieve results which on the whole are acceptable to common sense by applying at times the notion of increased risk, at others that of normality."<sup>65</sup>

Wagner notes that a similar flexibility has been seen in the courts' definition of the adequate cause test in cases of breach of contract.<sup>66</sup> He notes that it has been held that the damages claimed for must not be "beyond the inner relation with the breach of contract".<sup>67</sup> At other times, the possibility of the occurrence of harm because of the breach must not be "beyond any experience of life".<sup>68</sup> Similarly, courts have held that a breach is the adequate cause of harm if the breach created a risk which is generally capable of producing the kind of harm that occurred;<sup>69</sup> or if the risk of the occurrence of a specific loss was substantially increased.<sup>70</sup> In more general formulations the court has simply held that the adequate cause test merely aims to exclude liability for harm that falls beyond the expected course of things.<sup>71</sup>

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<sup>64</sup> RGZ 42, 291 as discussed in Hart & Honoré *Causation in the Law* 491.

<sup>65</sup> Hart & Honoré *Causation in the Law* 495.

<sup>66</sup> Wagner 2014 *Hanse LR* 83.

<sup>67</sup> BGH NJW, 1957, 1475 as cited in Wagner 2014 *Hanse LR* 83.

<sup>68</sup> BGH NJW-RR 2001, 887 888 as cited in Wagner 2014 *Hanse LR* 83.

<sup>69</sup> BGH NJW 2002, 2232 2233 as cited in Wagner 2014 *Hanse LR* 83.

<sup>70</sup> BGH NJW 1972, 195 197 as cited in Wagner 2014 *Hanse LR* 83.

<sup>71</sup> BGH NJW 2001, 514 515 as cited in Wagner 2014 *Hanse LR* 83.

The result is that the potential scope of the adequate cause test is imprecise, and at times very wide.<sup>72</sup> This has created a necessity for the test to be supplemented and refined – as was done with the acceptance of the *Schutzzwecklehre*.<sup>73</sup>

### 4 3 The *Schutzzwecklehre*

The previous section reveals that adequate causation as it had developed might not be precise enough to serve as an effective method for limiting liability for damages. This criticism was raised by several authors.<sup>74</sup> Von Caemmerer and Lange argued that the manner in which probabilities are estimated within a strict application of the adequate cause test would almost never lead to liability being excluded.<sup>75</sup> In addition to this, authors have also pointed out that the adequate cause test is especially harsh on defendants.<sup>76</sup> This is because an optimal observer can arguably be considered to have more knowledge than is fair to expect of a defendant.

In the light of this criticism, support increased for an additional method to limit liability for damages – the so-called *Schutzzwecklehre* or “protective purpose of the norm” approach.<sup>77</sup> This approach was first suggested by Rabel in 1932.<sup>78</sup> He argued that the meaning and purpose of the contract should determine the scope of liability of the

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<sup>72</sup> Wagner 2014 *Hanse LR* 84.

<sup>73</sup> Zweigert & Kötz *An Introduction to Comparative Law II* 269; Ebke & Finkin *Introduction to German Law* 206

<sup>74</sup> E Rabel *Das Recht des Warenkaufs I* (1936) 471-511 as cited in Jansen van Rensburg *Juridiese Kousaliteit* 210; E von Caemmerer *Das Problem des Kausalzusammenhangs im Privatrecht* Inaugural Address University of Freiburg (1956) as cited in Jansen van Rensburg *Juridiese Kousaliteit* 210; H Tarnowski *Die systematische Bedeutung der Adäquaten Kausalität für den Aufbau des Verbrechensbegriffs* 15 as cited in Hart & Honoré *Causation in the Law* 472; F Grispigni “Il nesso causale nel diritto penale” (1935) 13 *Riv. It. Dir. Pen.* 3 18-20 as cited in Hart & Honoré *Causation in the Law* 472.

<sup>75</sup> Von Caemmerer *Das Problem des Kausalzusammenhangs* as cited in Jansen van Rensburg *Juridiese Kousaliteit* 210; H Lange “Empfiehl es sich, die Haftung für schuldhaft verursachte Schäden zu begrenzen?” *Verhandlungen des 43. Deutschen Juristentages I* (1960) 12 as cited in Jansen van Rensburg *Juridiese Kousaliteit* 210.

<sup>76</sup> Treitel *Remedies for Breach of Contract* 166.

<sup>77</sup> H Beale, A Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Text on Contract Law* 2 ed (2010) 1011.

<sup>78</sup> E Rabel “Die Grundzüge des Rechts der unerlaubten Handlungen” (1932) *Deutsche Ref. Int. Kong. Rechtsvergl.* as cited in Hart & Honoré *Causation in the Law* 476.



defendant.<sup>79</sup> The approach was rephrased by Von Caemmerer in 1956 where he stated that

“...the question of the limits of liability is to be solved by deploying the meaning and range of a particular rule [or contractual term], not by applying general causal formulae.”<sup>80</sup>

In 1958 this theory was adopted by the *Bundesgerichtshof* and it has since widely been accepted in German contract law.<sup>81</sup> When deciding on the limits of liability, courts have therefore increasingly relied on the appropriate scope (*Schutzbereich*) of a breached contractual term, determined with reference to the contract’s purpose (*Normzweck*).<sup>82</sup>

This theory requires a teleological interpretation of the contractual provision that imposes the breached obligation.<sup>83</sup> The purpose of the contract is determined with reference to its content as well as all the circumstances surrounding its conclusion, in particular the intentions of the parties.<sup>84</sup> The relevant point in time for determining the contract’s purpose is that of contract conclusion, and not the moment of breach, as is the case with the adequate cause theory.<sup>85</sup> The intentions of the parties can be determined either objectively or subjectively. This gives a judge considerable discretion in the process of limiting or expanding contractual liability.<sup>86</sup>

The value of this test is its flexibility, given the realisation that purely mechanical and abstract standards cannot sufficiently solve the essentially normative question of the limits of liability.<sup>87</sup> The approach allows for the incorporation of fairness considerations which would otherwise not be taken into account in the adequate cause inquiry.<sup>88</sup>

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<sup>79</sup> Jansen van Rensburg *Juridiese Kousaliteit* 211.

<sup>80</sup> BGHZ 27 (1958), 37 as quoted in Hart & Honoré *Causation in the Law* 476.

<sup>81</sup> Hart & Honoré *Causation in the Law* 476; BGH NJW 1997, 2057 2058; BGH NJW 2002, 2459 2460 as cited in Wagner 2014 *Hanse LR* 84.

<sup>82</sup> 476.

<sup>83</sup> Zweigert & Kötz *An Introduction to Comparative Law II* 269.

<sup>84</sup> Beale et al *Cases, Materials and Texts on Contract Law* 1014.

<sup>85</sup> Treitel *Remedies for Breach of Contract* 166.

<sup>86</sup> Beale et al *Cases, Materials and Texts on Contract Law* 1014.

<sup>87</sup> Zweigert & Kötz *An Introduction to Comparative Law II* 269.

<sup>88</sup> Jansen van Rensburg *Juridiese Kousaliteit* 214.



Because of this it has been argued that the *Schutzzwecklehre* allows for more satisfactory limits on liability than adequate causation.<sup>89</sup>

The value of the *Schutzzwecklehre* should not be overestimated, however. In cases where a contractual provision has a clear and limited purpose, it might be a very effective tool for limiting liability.<sup>90</sup> Where that is not the case, however, the test would seem to rely too much on judicial discretion. As Hart and Honoré ask,

“[w]hy should the vague generalities of the adequacy theory be replaced by a still more incalculable notion, the *asylum ignorantiae* of judicial discretion?”<sup>91</sup>

In cases where a clear purpose and scope cannot be identified, the *Schutzzwecklehre* is indeed of no assistance.<sup>92</sup> It has been pointed out that strict adherents of the *Schutzzwecklehre* fall into the same trap that we saw with adequacy theorists. The adequacy theorists started using probabilistic terms to formulate a value judgment and therefore rendered much of the test an empty shell of its earlier logic. In other words, a decision was reached as to what would be a fair and equitable limit for liability, and this was then justified in terms of probabilities and in the language of the original adequate cause test. The notion of adequate cause was no longer a guideline to determine the limits of liability; it was rather used after the fact to explain a decision reached on other grounds.

In the same way, the *Schutzzwecklehre* approach has masked the normative exercise as an exercise in contractual interpretation. Now decisions based on discretionary and policy grounds are justified in terms of the court's interpretation of the purpose of the agreement. Arguably much of what is formulated as an interpretation of a provision does not do away with the discretionary nature of the exercise of limiting liability.<sup>93</sup>

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<sup>89</sup> Treitel *Remedies for Breach of Contract* 166.

<sup>90</sup> Hart & Honoré *Causation in the Law* 477.

<sup>91</sup> 477-478.

<sup>92</sup> Markesinis *Introduction to the German Law of Torts* 102.

<sup>93</sup> Jansen van Rensburg *Juridiese Kousaliteit* 215.

## 4 4 Adequate cause and foreseeability

### 4 4 1 Introduction

Not many South African writers have discussed the adequate cause theory.<sup>94</sup> When the theory did draw the attention of writers and courts, it was predominantly in the context of criminal law.<sup>95</sup> Indeed, most of the debate around the adequate cause test in South African law has been in the context of factual causation and the appropriateness of the *sine qua non* test.<sup>96</sup> A few writers have discussed the adequate cause theory in the context of delict,<sup>97</sup> but it does not seem to have been discussed in great detail as a method for limiting contractual damages. If we are to use the discussion above for a better understanding of the South African approach to remoteness in contract, however, the adequate cause theory has to be contextualised in the light of our current approach.

This section will explore the similarities and differences between the adequate cause theory and our current foreseeability-based approach. Broadly, there are two areas of comparison. First, both approaches refer to the concept of the “normal or usual course of events in human experience”. Secondly, the relevant time at which liability is determined is the same for both the foreseeability approach and the *Schutzzweck* approach, although the adequate cause test takes the moment of breach of contract, and not its conclusion, as the relevant point in time to determine liability.

### 4 4 2 The meaning of a “normal course of events”

Although the German courts have rejected foreseeability as a limit on the recovery of contractual damages,<sup>98</sup> there is an important similarity between the adequate cause

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<sup>94</sup> JC De Wet 1941 *THRHR* 126; JC Van der Walt “Enkele Gedagtes oor Nalatigheid en die Beperking van Deliktuele Aanspreeklikheid” (1964) 81 *SALJ* 504; WA Joubert “Oorsaaklikheid: Feit of Norm?” (1965) 6 *Codicillus* 6; JC Van der Walt “Vonnisbespreking: *Van den Bergh Parity Insurance Co. Ltd. and Another* 1966 (2) SA 621 (W)” (1966) 29 *THRHR* 244; Jansen van Rensburg *Juridiese Kousaliteit* 190-216.

<sup>95</sup> Burchell & Milton *Principles of Criminal Law* 213-214, 221-223.

<sup>96</sup> Joubert 1965 *Codicillus* 6.

<sup>97</sup> De Wet 1941 *THRHR* 126, Van der Walt 1964 *SALJ* 504, Van der Walt 1966 *THRHR* 244, Jansen van Rensburg *Juridiese Kousaliteit* 190-216.

<sup>98</sup> Treitel *Remedies for Breach of Contract* 164.

approach and that of foreseeability. Both rely on concepts such as “the normal course of events” or “natural consequences” and “the common experience of mankind”.<sup>99</sup>

In the case of the South African approach, general damage is that which flows “naturally and generally from the breach in question”,<sup>100</sup> and this is determined with reference to what would happen “in the normal course of things”.<sup>101</sup> Such harm would be deemed to have been contemplated by the parties, and would be recoverable as general damages.<sup>102</sup> In the case of the adequate cause test, at least in its broader formulation, a breach would be the adequate cause of harm if:

“...it has a tendency, according to human experience and in the ordinary course of events, to be followed by a [harm] of that sort.”<sup>103</sup>

As has been pointed out by the *Bundesgerichtshof*, the adequate cause test is primarily aimed at excluding the defendant’s liability for all the consequences of a breach that are beyond the “expected course of things”.<sup>104</sup> In this regard it is clear that both approaches will often lead to the same result – this has also been acknowledged by German writers.<sup>105</sup> According to Lange, the purpose of the adequate cause approach is to exclude liability for events that were not foreseeable.<sup>106</sup>

The two approaches differ, however, in that the adequate cause test tends to cast the net of liability wider than the foreseeability test.<sup>107</sup> To illustrate where the two approaches will diverge, Hart and Honoré refer to the same example of a miner who contracts tuberculosis. As has been explained above,<sup>108</sup> becoming a miner can be the adequate cause of contracting tuberculosis because it substantially increases the risk

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<sup>99</sup> Treitel *Remedies for Breach of Contract* 164; Markesinis & Unberath *The German Law of Torts* 113.

<sup>100</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 A 550.

<sup>101</sup> Van der Merwe et al *Contract* 367.

<sup>102</sup> Ch 2 (2 5).

<sup>103</sup> L Enneccerus & H Lehmann *Lehrbuch des Bürgerlichen Rechts* 15 ed (1958) 63 as translated in Hart & Honoré *Causation in the Law* 471.

<sup>104</sup> BGH NJW 2002, 2232 2233; BGH NJW 2001 514 515 as cited in Wagner 2014 *Hanse LR* 84.

<sup>105</sup> Hart & Honoré *Causation in the Law* 471.

<sup>106</sup> Jansen van Rensburg *Juridiese Kousaliteit* 191.

<sup>107</sup> AT von Mehren & JR Gordley *An Introduction to the Comparative Study of Law: The Civil Law System* 2 ed (1977) 1115.

<sup>108</sup> Ch 4 (2 1 2).

of contracting the disease. This can be deduced from the fact that proportionally more miners suffer from tuberculosis than human beings in general. In a case where a miner contracts tuberculosis because of his work at a mine, his mining activities were the adequate cause of the disease and it also occurred in the usual course of events. By contrast, if the miner moves to a mining town and marries a woman from whom he contracts the disease, his becoming a miner is still the adequate cause of the disease because his occupation increases the probability of increasing tuberculosis. However, it did not occur in the normal course of events for the miner due to the fact that it was not his occupation that caused the disease but rather his marriage. In terms of the foreseeability test, contracting tuberculosis from his wife will not be reasonably foreseeable and therefore it will be considered too remote.

A real-life example is the case discussed above where there had been a contract to tow two lighters and the lighters suffered damage in a storm as a result of the contractor's delay by one day.<sup>109</sup> The weather forecast for the day on which he did transport the lighters was favourable, and the storm was not foreseeable. His delay was the adequate cause of the harm, however. As Treitel points out, the adequate cause approach:

“...makes it possible for a German writer to ask (even if rhetorically) whether a tailor who delays in delivering travelling clothes to a customer who in consequence travels on a later train which crashes is to become liable to the customer for personal injuries which he suffers in the crash.”<sup>110</sup>

Another example used is that of a seller of a house who fails to transfer in time, and as a result of this the buyer is unable to accept an extraordinarily high offer on the house. The loss of profit that the buyer suffered would be of the kind that satisfies the adequate cause test and would therefore be recoverable.<sup>111</sup> In terms of the foreseeability approach, the lost profit would be regarded as unforeseeable and not

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<sup>109</sup> RGZ 81 (1913), 359 363 as quoted in Hart & Honoré *Causation in the Law* 478.

<sup>110</sup> Treitel *Remedies for Breach of Contract* 162, citing Enneccerus & Lehmann *Recht der Schuldverhältnisse* 73 and K Larenz *Lehrbuch des Schuldrechts I* 483.

<sup>111</sup> Treitel *Remedies for Breach of Contract* 166, citing Enneccerus & Lehmann *Recht der Schuldverhältnisse* 74.

something that occurs in the normal course of events. The buyer would at most be able to recover the loss of profits in respect of an ordinary or foreseeable offer.<sup>112</sup>

Where the adequate cause test and the foreseeability approach do not reach the same result with regards to whether damage has occurred “in the normal course of events”, it seems that the adequate cause test imposes wider liability than the foreseeability approach. However, it is important to note that in terms of the foreseeability approach in South African law, if damage does not occur in the “normal course of events”, that is not the end of the inquiry. One must still consider the contemplation and convention of the parties. The essential question is therefore how this next part of the foreseeability inquiry compares with the adequate cause approach. This will be explored in section 5. First, we turn to the second area of comparison between the two approaches: the moment for determining liability.

#### 4 4 3 The relevant moment for determining liability

A second marked difference between the two approaches is the point in time with reference to which the extent of liability is determined. As we have seen, the foreseeability approach operates with reference to the moment that the contract is concluded.<sup>113</sup> In the case of the adequate cause test, the extent of liability must theoretically be determined at the time of action by the defendant, because that is when the court wants to determine whether or not the action of the defendant increased the probability of the harm occurring.<sup>114</sup> This is of course not easily determinable in practice, and will many times be taken as the time of breach.<sup>115</sup> Regardless, the time of contract conclusion will not be relevant.

This is one aspect of the German approach that was fundamentally changed by the *Schutzzwecklehre*.<sup>116</sup> As we have seen, the *Schutzzwecklehre* requires that the purpose and scope of the breached contractual provision be determined with reference to the time of contract conclusion. The circumstances at the time of breach

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<sup>112</sup> Treitel *Remedies for Breach of Contract* 166.

<sup>113</sup> Ch 2 (2 5 3).

<sup>114</sup> Jansen van Rensburg *Juridiese Kousaliteit* 194.

<sup>115</sup> Treitel *Remedies for Breach of Contract* 166.

<sup>116</sup> 166.

would not be relevant. Given the fact that this issue is still controversial in our law,<sup>117</sup> it might be useful to consider the reasons for this shift in German law to a focus on the time of contracting as opposed to the time of breach.

Ernst Rabel's initial argument in support of the *Schutzzweck* approach was that liability for damages has to be rooted in the (presumed or actual) intentions of the parties.<sup>118</sup> This is a fundamental premise that underlies both the foreseeability approach and the *Schutzzwecklehre*, as explained previously.<sup>119</sup> Both theories are premised on the idea that the limits of liability for contractual damages should be determined with reference to what parties could reasonably have taken into consideration when contracting. The foreseeability approach determines what parties could have taken into account with reference to what they could have foreseen, whilst the *Schutzzweck* approach determines this with reference to the purpose of their agreement. If the limits of liability are determined with reference to what parties could reasonably have taken into account at contract conclusion, it does appear that the moment of contract conclusion must be the relevant moment for determining such limits. It is upon contract conclusion that parties decide on the obligations and risks for liability that they are assuming, and it is only at this point where they reasonably are able to bargain for such risks or potential liabilities.

This issue will be discussed in depth in the final chapter of this study when the underlying rationale of the remoteness inquiry will be explored. For now it suffices to note that the *Schutzzwecklehre* and the foreseeability approach both focus on the moment of contract conclusion, arguably because of their shared underlying emphasis on what parties could have taken into consideration when contracting.

## 4 5 Evaluation

The adequate cause approach has been subjected to considerable criticism.<sup>120</sup> Much of it relates to the seemingly technical nature of the test and its almost scientific focus

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<sup>117</sup> Ch 2 (2 5 4).

<sup>118</sup> E Rabel *Das Recht des Warenkaufs – Eine Rechtsvergleichende Darstellung I* 491-497.

<sup>119</sup> Ch 2 (2 3 3 2 2).

<sup>120</sup> A thorough overview is provided in Jansen van Rensburg *Juridiese Kousaliteit* 195-201; Hart & Honoré *Causation in the Law* 483-495. For more recent criticism, see B Markesinis *A Comparative Introduction to the German Law of Torts* 101.

on probabilities. The most convincing criticism is probably the argument that the entire exercise of estimating probabilities can be manipulated with one's definition of cause and consequence. This can be illustrated with an example used by Von Kries.<sup>121</sup>

In his example a coachman falls asleep, the coach consequently deviates from its course and a passenger is struck by lightning and dies. In this case, whether or not his falling asleep is an adequate cause of the death of the passenger depends only on whether the consequence is described as "death" or as "death by lightning". In the former case it would be an adequate cause since the probability of death is increased significantly when the coachman falls asleep, but in the latter case not.

Some other points of criticism against the adequate cause theory will sound familiar in a South African context – such as the uncertainty about the required degree to which a cause would have to increase the probability of a consequence to be considered adequate.<sup>122</sup> This is also asked in the foreseeability context: with what probability must a consequence be foreseeable before liability for that consequence will be imposed?<sup>123</sup> What may be taken from the overview of the adequate cause approach is that the search for a strict definition or range of probabilities within which to limit liability is futile. As we have seen in the discussion of the adequate cause theory, any answer to this question can be manipulated. Moreover, the emphasis on a specific level of probabilities loses sight of the normative nature of the exercise.

Apart from these two points, a detailed overview of the criticism of the adequate cause theory falls beyond the scope of this chapter – especially in the cases where the foreseeability and adequate cause approaches will yield similar results. If the notion of a "normal course of events" allows both theories to reach similar answers, there is no reason to delve further into the technical criticism of the adequate cause theory. In these cases, the application of the adequate cause theory will not lead to outcomes different to those which result from an application of the foreseeability theory.

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<sup>121</sup> J Von Kries *Über den Begriff der objektiven Möglichkeit und einiger Anwendungen desselben* (1888) 532 as discussed in Hart & Honoré *Causation in the Law* 470.

<sup>122</sup> Hart & Honoré *Causation in the Law* 485.

<sup>123</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 580G.



What remains to be explored, however, are cases where the two tests would yield different results. If, according to the foreseeability approach as followed in South Africa, one finds that damage is not the natural result of the breach, one would next turn to the contemplation and convention principles.<sup>124</sup> Here, the court would seek to ascertain whether the special circumstances that resulted in the unusual damage were known to the parties. If it can be reasonably presumed that the parties ought to have foreseen the damage or actually did foresee the damage based on their knowledge of special circumstances, and that they contracted on the basis of such knowledge, the special damages would be recoverable. As explained earlier, this approach aims to give effect to the parties' intentions (or to protect reliance on a reasonable assumption as to the other party's intention). In other words, the limits of liability for damages is determined with reference to what parties ought to have foreseen, as this is taken to be indicative of what they might have intended to have submitted to.<sup>125</sup>

The *Schutzzwecklehre* is based on the same premise. It was implemented to correct the overbroad scope of liability that arises from an application of the adequate cause test alone.<sup>126</sup> This is done by determining to what extent parties might have submitted to liability for damages, which is ascertained with reference to the purpose of the agreement between the parties.

It would seem therefore, that even where the adequate cause and foreseeability approaches do not yield similar results with regard to what the "normal course of events" would be, both resolve the issue of remoteness with reference to what parties could reasonably have taken into account when contracting. The foreseeability approach has done this by incorporating a contemplation requirement, and the adequate cause approach by its refinement in the *Schutzzwecklehre*. The South African approach goes further, however. It also requires convention – that parties entered into the contract in view of their contemplation. The appropriateness of this will be fully explored in the next chapter with reference to English law, where the debate on this has been especially lively in the aftermath of the *Achilleas*<sup>127</sup> decision.

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<sup>124</sup> Ch 2 (2 5).

<sup>125</sup> Ch 2 (2 3 3 2 2).

<sup>126</sup> Treitel *Remedies for Breach of Contract* 166; Jansen van Rensburg *Juridiese Kousaliteit* 210.

<sup>127</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas*. [2009] 1 AC 61.



For purposes of this chapter it suffices to note that, if we are to accept the consideration of what parties could have taken into account when contracting as the underlying reason for limiting damages that occur outside of the “normal course of events”, foreseeability is only one way to do so. The *Schutzzwecklehre* offers another approach to give effect to the same principle.

The *Schutzzwecklehre* also faces serious limitations: most importantly the fact that it is not always possible to identify a limited purpose and protective scope for a contractual provision.<sup>128</sup> In such cases the test would rely too much on judicial discretion. It might not be a perfect alternative to our current foreseeability approach, but it might serve as a useful supplement to it. This will especially be the case if we are to move in the direction of a more flexible and policy-based approach to limiting contractual damages as suggested in *Thoroughbred Breeders' Association v Price Waterhouse*.<sup>129</sup> This will be considered in chapter six and seven. The following chapter, however, will focus on the foreseeability theory in English law.

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<sup>128</sup> Hart & Honoré *Causation in the Law* 477.

<sup>129</sup> 2001 4 SA 551 (SCA) 583A-583C.



## CHAPTER 5: THE FORESEEABILITY THEORY: THE ENGLISH APPROACH

### 5 1 Introduction

The previous chapters have explored two alternatives to the foreseeability theory: the direct consequences theory and the adequate cause theory. This has produced several insights into the strengths and weaknesses of these alternative approaches. We now turn to the theory of remoteness applied in South African law: the foreseeability theory.

As we have seen,<sup>1</sup> South African courts have relied heavily on English law in their formulation of the rules of remoteness in contract law. The classic English decision on the issue, *Hadley v Baxendale*<sup>2</sup> (“*Hadley*”), is still often referred to by our courts<sup>3</sup> and forms the basis of the South African approach.<sup>4</sup> Therefore, this chapter will provide an overview of the reasonable contemplation test as set out in the *Hadley* decision and its subsequent development in English law. The ways in which the English approach to reasonable contemplation can contribute to the development of the South African position on the issue of remoteness will also be explored.

This chapter will then turn to the recent development in English law towards an agreement-centred understanding of remoteness in contract. This understanding is reflected in the “assumption of responsibility” test that was formulated in *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* (“*The Achilleas*”).<sup>5</sup> In this case, the House of Lords expressed the opinion that reasonable contemplation is not a limit on liability for contractual damages in its own right, but rather that it serves as a useful tool for determining what the parties had intended that limit to be. The proper limit on

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<sup>1</sup> Ch 2 (2 5).

<sup>2</sup> *Hadley v Baxendale* [1854] 9 Ex. 341.

<sup>3</sup> *Thoroughbred Breeders’ Association v Price Waterhouse* 2001 4 SA 551 (SCA) 579D-580A.

<sup>4</sup> JW Wessels *The Law of Contract in South Africa II* (1937) 936.

<sup>5</sup> [2009] 1 A.C. 61.

contractual liability, according to this case, must be determined with reference to the parties' intentions and can be deduced from the agreement itself.<sup>6</sup>

This development and the subsequent academic debate that has been ignited focus on the nature of the rules governing remoteness in the law of contract. The debate centres around two different conceptions of the remoteness inquiry. On the one hand, some argue that the rules of remoteness determine how the parties had intended to allocate risk for losses – therefore, that the rules essentially operate with reference to the contractual context and the agreement itself. On the other hand, it is argued that the rules of remoteness are gap-filling devices that allocate risk where the parties have failed to do so – they are rules that originate outside of the agreement.<sup>7</sup> The remoteness inquiry in the English law of contract is therefore either approached as a rule of thumb for determining what the parties have agreed upon, or as a default rule to operate in the absence of an agreement.<sup>8</sup>

The aim of this chapter is to gain insight into the contemplation principle as currently applied in South Africa by looking at how English law has dealt with its version of this test since the *Hadley* decision. Additionally, the debate around the proper role that parties' intentions should play in the allocation of risk for losses caused by breach will be explored. This will be done in the light of the controversy surrounding the convention principle in South African law.<sup>9</sup>

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<sup>6</sup> E Peel *The Law of Contract* 13 ed (2011) 1057. There are some authors who have argued that the *Achilleas* decision does not reflect a *ratio decidendi* supporting the assumption of responsibility test – see for example, H McGregor *McGregor on Damages* 18 ed (2009) 6-173. However, it seems to have been confirmed by the courts that the assumption of responsibility test is indeed binding and part of the English law of remoteness of damages – most recently in *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146 para 69.

<sup>7</sup> M Harris "Fairness and Remoteness of Damage in Contract Law: A Lexical Ordering Approach" (2012) 28 *JCL* 122 142.

<sup>8</sup> A Kramer "An Agreement-Centred Approach to Remoteness in Contract" in N Cohen & E McKendrick (eds) *Comparative Remedies for Breach of Contract* (2005) 249 250.

<sup>9</sup> Ch 2 (2 5 3).

## 5 2 The reasonable contemplation test

### 5 2 1 The *Hadley* decision

As indicated in chapter 2, the *locus classicus* on the matter of remoteness of contractual damages in English law is the *Hadley* case.<sup>10</sup> The case dealt with a carrier contract in which the plaintiffs gave their broken millshaft to the defendants, who had to take it to manufacturers to enable them to make a new millshaft as a replacement for the broken one. The defendants were aware of the fact that the item to be transported was a millshaft and that the plaintiffs were the owners of a mill. The defendants breached the contract by delaying unreasonably in delivering the broken millshaft to the manufacturers.

Until the new millshaft was installed, the plaintiffs' mill could not operate at all. The plaintiffs claimed damages for the loss of profit they suffered during this delay.<sup>11</sup> The court held that these losses could not be recovered. The reason was that the facts which the defendants were taken to know were not sufficient to

“[show]... that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carriers to a third person.”<sup>12</sup>

According to the court, therefore, the fact that the defendants knew that they were delivering a millshaft and that the plaintiffs were the owners of a mill did not make it reasonable to suppose that the defendants should have known that a delay in delivering the millshaft would cause the plaintiffs lost profits. The mill might have had another shaft to operate in the interim, or there might have been other defects in the machinery that contributed to the standstill of the mill.<sup>13</sup>

The rule was set by the court as follows:

“[W]here two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such a breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such a breach of contract itself, or such as may be

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<sup>10</sup> *Hadley v Baxendale* [1854] 9 Ex. 341; McGregor *Damages* 199.

<sup>11</sup> *Hadley v Baxendale* [1854] 9 Ex. 341 341.

<sup>12</sup> 355.

<sup>13</sup> 355.

reasonably supposed to have been in the contemplation of both parties, at the time when they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the claimants to the defendants and this known to both parties, the damages resulting from such a breach of contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, would be only supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case.”<sup>14</sup>

On these facts, the court held that the standstill of the mill was not a natural result of the breach.<sup>15</sup> It was therefore not reasonable to hold that the defendants should have contemplated loss of profit as a result of their delay. The defendants would have been liable if they had known that the mill was dependent on the delivery of the new shaft to operate. But such knowledge was not proven.<sup>16</sup> If they had such knowledge, they might have tried to limit their liability when negotiating the contract. And, the court held, “of this advantage it would be very unjust to deprive them”.<sup>17</sup>

The rule set out in *Hadley* may be divided into two limbs: the first dealing with harm or loss that arises in the normal course of events, and the second with harm or loss that does not.<sup>18</sup> In terms of the first limb, a defendant will always be liable for all loss that arises in the normal course of events. Such loss is considered to have been reasonably foreseeable – and a defendant is deemed by law to have foreseen it, even if he subjectively did not.<sup>19</sup> This is because it is assumed that the defendant, reasonably able to foresee the loss, had the opportunity to limit his liability.<sup>20</sup> If he had not done so, it is not for the court to impose such a limitation.

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<sup>14</sup> 354-355.

<sup>15</sup> Peel *Law of Contract* 1049.

<sup>16</sup> S Harder *Measuring Damages in the Law of Obligations* (2010) 37.

<sup>17</sup> *Hadley v Baxendale* [1854] 9 Ex. 341 355.

<sup>18</sup> McGregor *Damages* 202.

<sup>19</sup> PS Atiyah *An Introduction to the Law of Contract* 5 ed (1995) 465.

<sup>20</sup> Peel *Law of Contract* 1054.

Even if all loss that arises in the normal course of events is reasonably foreseeable, not all reasonably foreseeable loss occurs in the normal course of events.<sup>21</sup> This is what the second limb of the *Hadley* test addresses. If the defendant had sufficient notice of facts that made unusual (or special) damage reasonably foreseeable at the time of contract conclusion, he will be liable for that loss as well.

The *Hadley* decision did not impose liability for special damages and therefore did not have to discuss in detail the requirements for such liability. From the decision, it was clear that, if the defendants had known about the specific circumstances rendering these unusual losses likely, they might have been liable. Mere knowledge of such circumstances, however, would not have been sufficient to impose liability.<sup>22</sup> Rather, a defendant would only have been liable for all losses that ordinarily follow from these "known and communicated" special circumstances. The court's reason was that, if such losses could have been contemplated, parties could have taken it into account when contracting. Accordingly, early cases interpreted *Hadley* as imposing a requirement for a tacit agreement or implied promise to be liable for losses that occur outside of the normal course of events.<sup>23</sup>

This interpretation was subsequently rejected.<sup>24</sup> Rather, it was understood that the undertaking to be liable for reasonably foreseeable special damage is implied by law (and not in fact). The defendant would be liable for exceptional losses regardless of any actual agreement to that effect.<sup>25</sup> Therefore, the second limb of the *Hadley* test was firmly established not with reference to the underlying agreement of the parties, but rather to function as a "limiting principle of policy".<sup>26</sup> In other words, the limitation of contractual damages is determined with reference to considerations external to the

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<sup>21</sup> Atiyah *Introduction to the Law of Contract* 465.

<sup>22</sup> Peel *Law of Contract* 1054, citing *Mulvenna v Royal Bank of Scotland* [2003] EWCA Civ 1112.

<sup>23</sup> *British Columbia and Vancouver's Island Spar, Lumber and Saw-Mill Co v Nettleship* (1868) LR 3 CP 499; *Horne v Midland Railway* (1873) LR 7 CP 583.

<sup>24</sup> *GKN Centrax Gears v Matbro Ltd* [1976] 2 Lloyd's Rep 555.

<sup>25</sup> Peel *Law of Contract* 1054.

<sup>26</sup> *Satef-Huttenes Albertus SpA v Paloma Tercera Shipping Co SA (The Pegase)* [1981] 1 Lloyd's Rep 175 181.

agreement itself – it is therefore a default rule of law that operates outside of the contract.<sup>27</sup>

## 5 2 2 Further developments in the application of the reasonable contemplation test

The next important refinement of the reasonable contemplation test as set out in *Hadley* was developed in *Victoria Laundry (Windsor Ltd) LD v Newman Industries LD* (“*Victoria Laundry*”).<sup>28</sup> This decision clarified two important aspects of the test.

The first aspect was that the reasonable contemplation test as set out in *Hadley* was not really two tests, but rather one test that operated with reference to two different types of knowledge. In the words of the court:

“[T]he aggrieved party is only entitled to recover such part of the loss... as was at the time of the contract reasonably foreseeable as liable to result from the breach. What is at that time reasonably foreseeable depends on the knowledge then possessed by the parties... For this purpose, knowledge ‘possessed’ is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the ‘ordinary course of things’ and consequently what loss is liable to result from a breach of contract in that ordinary course. This is the subject matter of the ‘first rule’ in *Hadley v Baxendale*. But to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses, of special circumstances outside the ‘ordinary course of things’, of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the ‘second rule’ so as to make additional loss recoverable.”<sup>29</sup>

The court clarified that both rules set out in *Hadley* rely on the same underlying principle: a defendant would be liable for loss that a reasonable person in those circumstances, given the defendant’s knowledge, would have foreseen.<sup>30</sup> Under the first rule in *Hadley*, a defendant is deemed by law to have knowledge of all loss that would occur in the normal course of events. He will therefore be liable for all such loss. Under the second rule, the defendant will be liable for all loss that a reasonable person in his position, with his actual knowledge, would have foreseen as likely to result from

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<sup>27</sup> N Andrews, M Clarke, A Tetterborn & G Virgo *Contractual Duties: Performance, Breach, Termination and Remedies* (2011) 443.

<sup>28</sup> (1949) 2 KB 528.

<sup>29</sup> 539.

<sup>30</sup> D Winterton *Money Awards in Contract Law* (2015) 231.



his breach. The two tests are therefore not analytically distinct – rather, a defendant’s liability increases with his knowledge.<sup>31</sup>

The second aspect of the reasonable contemplation test that was clarified in *Victoria Laundry* is that the test for remoteness is not concerned with the actual contemplation of the parties.<sup>32</sup> The court stated:

“In order to make a contact-breaker liable under either rule it is not necessary that he should actually have asked himself what loss is liable to result from a breach. As has often been pointed out, parties at the time of contracting contemplate not the breach of the contract, but its performance. It suffices that, if he had considered the question, he would as a reasonable man have concluded that the loss in question was liable to result.”<sup>33</sup>

In the case of special damages, therefore, the only subjective inquiry is the determination of what a defendant actually knew. The court then considers whether or not the loss suffered was of a kind that a reasonable person with the defendant’s knowledge would have foreseen as likely to occur. If that is the case, the defendant would be liable for such loss.<sup>34</sup> His actual foresight and contemplation is never part of the inquiry.

The final important development of the reasonable contemplation test was articulated in the case of *Czarnikow v Koufos, The Heron II* (“*The Heron II*”).<sup>35</sup> In this case the House of Lords addressed the uncertainty surrounding the degree of likelihood with which loss must have been foreseeable for liability to be imposed. Lord Reid attacked the blanket use of the term “reasonable foreseeability” as unclear and confusing.<sup>36</sup> The decision formulated the required level of probability with which damage must be

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<sup>31</sup> Peel *Law of Contract* 1055.

<sup>32</sup> Harder *Measuring Damages* 39, citing *Foaminol Laboratories Ltd v British Artide Plastics Ltd* [1941] 2 All E.R. 393 400.

<sup>33</sup> *Victoria Laundry (Windsor) LD v Newman Industries LD* [1949] 2 K.B. 528 CA 540.

<sup>34</sup> Peel *Law of Contract* 1051.

<sup>35</sup> [1969] 1 A.C. 350.

<sup>36</sup> 384.

foreseeable as “a serious possibility”,<sup>37</sup> “a real danger”,<sup>38</sup> “very substantial”,<sup>39</sup> “not unlikely”<sup>40</sup> or “easily foreseeable”.<sup>41</sup>

Regardless of this attempt at clarification, there is still uncertainty about the degree of likelihood with which loss ought to have been foreseeable before it becomes recoverable.<sup>42</sup> As we have seen previously,<sup>43</sup> a specifically defined level of probability does not necessarily render the results of the remoteness inquiry more predictable. Often, the facts of each case will be interpreted and framed in a particular way to fall inside or outside of whatever the probability level has to be. Any attempt at delineating a very clear-cut range of probabilities within which harm must be foreseeable will arguably be fruitless. In *Thoroughbred Breeders’ Association v Price Waterhouse*<sup>44</sup> the South African position on the matter was set out as follows:

“what is required to be reasonably foreseeable is not that the type of event or circumstance causing the loss will in all probability occur but minimally that its occurrence is not improbable and would tend to follow upon the breach as a matter of course.”<sup>45</sup>

This position seems to provide a guideline without attempting to formulate a hard and fast rule of probabilities. It seems that English law has, despite the heavy debate on the issue, not reached a more satisfactory answer.<sup>46</sup>

### 5 2 3 Criticism of the reasonable contemplation test

The reasonable contemplation test, despite the courts’ continued adherence to it, has not been without criticism. One of the issues that has been highlighted by academics and courts alike is that the test is imprecise. An example of this imprecision is the use of the phrase “damage which occurred in the usual course of things”. The test does

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<sup>37</sup> 414-415.

<sup>38</sup> 425.

<sup>39</sup> 388.

<sup>40</sup> 383.

<sup>41</sup> 383.

<sup>42</sup> Harder *Measuring Damages* 48.

<sup>43</sup> Chapter 4 section 5.

<sup>44</sup> 2001 4 SA 551 (SCA).

<sup>45</sup> 581H-581I.

<sup>46</sup> For more on the debate in English law, see for example Harder *Measuring Damages* 48; *Parsons (Livestock) Ltd v Uttley Ingham & Co Ltd* [1978] QB 791 (CA).

not indicate to what extent a court may take into account the commercial context within which the contract was concluded when determining whether or not a specific course of events can be regarded as usual.<sup>47</sup>

The second point of criticism raised against the reasonable contemplation test is that it is restrictive due to its emphasis on the knowledge of parties and the likelihood of harm occurring. The test as it has been formulated and applied cannot take into account other, arguably important, factors. For example, the test does not take into account the proportionality between harm suffered and the breach committed, the nature of the particular contract in question, or public policy considerations.<sup>48</sup> This criticism of the restricted manner in which the test has developed is concisely summarised by Lord Hoffmann:

*“Hadley v Baxendale is a very good example of a tendency which is endemic in a system of precedent, namely, for judges to take the ground upon which a particular case was decided as the sole criterion upon which different cases should be decided. That leads to an impoverishment of reasoning in subsequent authorities.”*<sup>49</sup>

The final point of criticism raised against the reasonable contemplation test is that its theoretical outcomes are not necessarily manifested in court decisions on the issue. This is because courts have tried to keep within the terminology of the test, while at the same time allowing for just outcomes. Some authors argue that the reasonable contemplation test is in fact merely a flexible policy tool, or a set of tests, that can be used by judges to secure just outcomes.<sup>50</sup> However, such a view of the test does not respond to the criticism, because

*“the practice of disguising substantive principles in another form should be avoided where possible. This kind of camouflage is a shortcoming, not a strength, of the rule as stated in Hadley and related cases. It militates against transparency in decision-making, and undermines certainty by not exposing the real reasons underpinning conclusions in the case law.”*<sup>51</sup>

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<sup>47</sup> Harris 2012 *JCL* 125.

<sup>48</sup> 127.

<sup>49</sup> L Hoffmann *“The Achilles: Custom and Practice or Foreseeability?”* (2010) 14 *Edin. L.R.* 47 53.

<sup>50</sup> Harris 2012 *JCL* 130.

<sup>51</sup> 130.

Arguably, these points of criticism can also be raised against the South African approach to remoteness. It may be in recognition of difficulties such as those highlighted above that our Supreme Court of Appeal has suggested that the exclusive criteria currently used to determine remoteness might become only one of several tests in the future.<sup>52</sup> The future development of the South African approach to remoteness will depend on how our courts view and deal with the convention requirement, however. This is an issue that can be better evaluated against the background of the adoption of the so-called assumption of responsibility test in English law.

### 5 3 The assumption of responsibility test

#### 5 3 1 The *Achilleas* decision

The *Achilleas* decision is widely regarded as a watershed in the development of the modern English law on contractual damages. In *Achilleas* the judges took it upon themselves, in the words of Lord Walker, “to revisit some important general issues [which are] all aspects of how the rule in *Hadley v Baxendale* has been developed”.<sup>53</sup>

The case concerned a charter contract in terms of which the chartered ship was due to be returned to its owners (the plaintiffs) on 2 May 2004. With this expected day of return in mind, the plaintiffs signed a second charter contract with a different company at an increased daily rate. In terms of this second agreement the company would have a right to cancel the contract if the ship did not become available by 8 May. The defendants were delayed and it became apparent that they would not return the ship by 8 May. In order to avoid the cancellation of the second charter agreement, the plaintiffs had to renegotiate its terms. To extend the date from when cancellation could be elected to 11 May, they had to agree to reducing the daily rate by \$8 000 from \$39 500 to \$31 500.

The plaintiffs claimed damages for breach of contract in the amount of the difference between the rate that they would have received in terms of the second agreement and the renegotiated rate, for the entire duration of the agreement – a princely amount of

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<sup>52</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 583G-583H.

<sup>53</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] 1 A.C. 61 66.

\$1 364 584.<sup>54</sup> The defendants in turn were only willing to pay the difference between the market rate and the charter rate for the 9 day “overrun” period between the date it was supposed to deliver the carrier (2 May), and the actual date of delivery (9 May).

In the judgment of the Court of Appeal, it was clear from the judges’ decision that the case dealt with the first limb of the *Hadley* test.<sup>55</sup> Rix LJ stated that the refixing of the rate was “not unlikely” and “highly probable” to occur in the normal course of events.<sup>56</sup> Damages that occur in the normal course of events are, in terms of the reasonable contemplation test, recoverable. According to the Court of Appeal, any reasonable person in the charterer’s position would have contemplated the loss suffered as arising naturally and according to the usual course of things from a failure to deliver a ship at the agreed upon time.<sup>57</sup> Therefore, the plaintiffs were entitled to claim the difference between the first and the second (renegotiated) rate for the entire duration of the charter agreement.

The charterers appealed to the House of Lords. They argued that there was a common understanding in the shipping industry that damages in such cases would consist only of the difference between the market and the agreed charter rates for the overrun period.<sup>58</sup> The appeal was unanimously allowed by the House of Lords, but for different reasons.<sup>59</sup>

### 5 3 1 1 *The judgments of Lords Hoffmann and Hope*

Lords Hoffmann and Hope focussed their decisions on what they considered to be the underlying basis of the remoteness inquiry – the intentions of the parties at contract conclusion.<sup>60</sup> Lord Hoffmann explained his reasoning as follows:

“It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken. It must be in principle wrong to hold someone liable for risks for which the people entering into

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<sup>54</sup> 61.

<sup>55</sup> D Winterton *Money Awards in Contract Law* 231.

<sup>56</sup> *Transfield Shipping Inc v Mercator Shipping Inc, The Achilles* [2006] EWHC 3030 (Comm) para 96.

<sup>57</sup> Paras 55-56.

<sup>58</sup> D Winterton *Money Awards in Contract Law* 231.

<sup>59</sup> Peel *Law of Contract* 1056.

<sup>60</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilles* [2009] 1 A.C. 61 68.

such a contract in their particular market, would not reasonably be considered to have undertaken.”<sup>61</sup>

Accordingly, both judges argued that the (presumed or actual) intentions of the parties form the fundamental premise upon which the limits of liability for damages are based. They held that this is also the justification for the reasonable contemplation test. In other words, the rule that loss must have been reasonably foreseeable

“is a *prima facie* assumption about what the parties may have taken to have intended, no doubt applicable in a great majority of cases but capable of rebuttal.”<sup>62</sup>

As a result, the judges found that the fact that loss was foreseeable was not decisive to determine liability. The real test, of which foreseeability would often be a *prima facie* indication, is whether or not a defendant can reasonably be taken to have assumed responsibility for the loss in question.

Accordingly, they found that even if the charterer could have foreseen the damage in question, he was still not liable because he had not accepted responsibility for those damages. They based this conclusion on the commercial context within which the contract was concluded. In particular, they referred to the fact that the defendants had no control over the duration of the second charter agreement, and that the market understanding was that liability of the charterer was limited to the overrun period.<sup>63</sup>

### 5 3 1 2 *The judgments of Lady Hale and Lord Roger*

Lady Hale and Lord Roger reached the same conclusion, albeit by means of application of the traditional reasonable contemplation test. They held that the defendant was not liable because the loss in question was not reasonably foreseeable and therefore too remote.<sup>64</sup> This conclusion was reached particularly with reference to the fact that the market had been very volatile,<sup>65</sup> which exacerbated the loss suffered by the plaintiffs. According to them such volatility rendered the extent of the damage suffered unforeseeable.

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<sup>61</sup> 68.

<sup>62</sup> 67.

<sup>63</sup> 71.

<sup>64</sup> 91.

<sup>65</sup> 90.

The application of the reasonable foreseeability test by these two judges is problematic, however. The Court of Appeal had applied the exact same test with the opposite result. The decision by Lady Hale and Lord Roger did not focus on whether the loss itself was foreseeable, but only on whether its extent was foreseeable.<sup>66</sup> This is clearly not in accordance with the reasonable contemplation test, as it only requires foreseeability of a type or kind of loss and not its extent. Indeed, Peel points out that market fluctuations have been held as an example of something that ought to be considered foreseeable at contract conclusion.<sup>67</sup> As far as the application of the reasonable contemplation test goes, therefore, the conclusion of the Court of Appeal is generally preferred to that of Lady Hale and Lord Roger.<sup>68</sup>

### 5 3 1 3 *The judgment of Lord Walker*

The fifth decision by Lord Walker is not easy to classify as following either one of the two approaches outlined above.<sup>69</sup> He supported aspects of both approaches, rendering the reasons for his conclusion unclear.<sup>70</sup> Initially, this led to some debate as to whether the assumption of responsibility test, as set out by Lords Hoffmann and Hope, was indeed binding law. McGregor was especially sceptical about the value of the judgment and even found that it did not yield a *ratio decidendi*, which implied that the established position prevailed.<sup>71</sup> It is not a debate that needs to be explored, as subsequent cases have accepted and applied the test,<sup>72</sup> and even McGregor conceded that the *Achilleas* “appears to be here to stay with us, at least for the time being”.<sup>73</sup> The assumption of responsibility test has also been accepted by academics

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<sup>66</sup> Peel *Law of Contract* 1056.

<sup>67</sup> 1056.

<sup>68</sup> 1056.

<sup>69</sup> D Winterton *Money Awards in Contract Law* 234.

<sup>70</sup> McGregor *Damages* 209.

<sup>71</sup> D Campbell “The Law of Contract Damages – Adam Kramer” (2015) 131 *LQR* 325 327.

<sup>72</sup> *Ryan v London Borough of Islington* [2009] EWCA Civ 578; *Siemens Building Technologies FE Ltd v Supershield Ltd* [2010] EWCA Civ 7; *Rubenstein v HSBC Bank Plc* [2012] EWCA Civ 1184; *John Grimes Partnership Ltd v Gubbins* [2013] EWCA Civ 37. Most recently, the test was applied in *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146.

<sup>73</sup> D Campbell 2015 *LQR* 327.

either as a new development or at least a reformulation of the reasonable contemplation test.<sup>74</sup> It therefore forms part of English contract law.

### 5 3 2 The operation of the assumption of responsibility test

The test as set out and applied in the *Achilleas* decision founds liability for damages on the presumed intentions of the parties.<sup>75</sup> Where such intentions cannot be deduced from the express terms of the contract, the court must take into account the larger business context in which the contracting took place.<sup>76</sup> The approach is formulated by Professor Green in the following excerpt that has been quoted in support of the assumption of responsibility test:<sup>77</sup>

“Parties, in making contracts, rarely contemplate *the losses* which would result from its breach. But they do count the advantages they will gain from its performance. *What interests does the contract promote or serve?* These are actually considered in the most part, and those which are shown to have been considered or reasonably falling within the terms [of the contract] in view of the language used and the background of the transaction; mark its boundaries – the limits of protection under it. Did the parties intend (using intention in the sense indicated above) that the injured interest was to be protected? Did this agreement fairly comprehend the advantage now claimed to have been lost? If such was not so intended or comprehended necessarily there can be no recovery for damages resulting from the injury or loss.”<sup>78</sup>

The test therefore requires the interpretation of the contract against its commercial background, taking into account the words used, the contractual context, the factual matrix and the purpose of the contract.<sup>79</sup> The test’s focus on the purpose of the contract might suggest similarities to the *Schutzzwecklehre* as seen in German law,<sup>80</sup> but it is clear that the assumption of responsibility test is broader in its focus. This is because the assumption of responsibility test takes into account not only the purpose

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<sup>74</sup> Peel *The Law of Contract* 1048.

<sup>75</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] 1 A.C. 61 71.

<sup>76</sup> RA Epstein “Beyond Foreseeability: Consequential Damages in the Law of Contract” in RG Frey & CW Morris (eds) *Liability and Responsibility: Essays in Law and Morals* (1991) 89 90.

<sup>77</sup> See for example A Kramer *The Law of Contract Damages* (2014) 291.

<sup>78</sup> L Green *The Rationale of Proximate Cause* (1927) 51 (emphasis in the original).

<sup>79</sup> Kramer *Contract Damages* 291.

<sup>80</sup> Ch 4 (4 3).



of a breached provision, but also the commercial context in which it was concluded as well as the broader factual matrix.

### 5 3 3 Impact on the reasonable contemplation test

The *Achilleas* decision represents a departure from the reasonable contemplation test.<sup>81</sup> It seeks to determine remoteness of damages with reference to the implicit risk allocation underlying the parties' agreement.<sup>82</sup> This amounts to a rejection of the original conception of the reasonable contemplation test in *Hadley* as a default rule that operates outside of the parties' agreement. However, the practical impact of this departure is not necessarily far-reaching. Even in terms of the assumption of responsibility test, foreseeability remains at the heart of the inquiry. Foreseeability is now treated as a rule of thumb or *prima facie* indication of parties' intentions.<sup>83</sup>

The liability that would have been imposed by the reasonable contemplation test can therefore be restricted or expanded with reference to the assumption of responsibility by the defendant.<sup>84</sup> This view of the assumption of responsibility test has been confirmed by the Queen's Bench.<sup>85</sup> Essentially therefore, courts have understood the *Achilleas* decision to subject the reasonable contemplation test to an overriding "assumption of responsibility" inquiry. Reasonable foreseeability will still be indicative of the proper limits of liability for damages, except where a contract's nature or commercial context, or indeed any "other relevant special circumstances"<sup>86</sup> indicate that the outcome of the reasonable foreseeability test does not accurately reflect the parties' intentions.<sup>87</sup>

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<sup>81</sup> Harder *Measuring Damages* 47.

<sup>82</sup> Winterton *Money Awards in Contract Law* 231.

<sup>83</sup> Kramer *Contract Damages* 290.

<sup>84</sup> 311.

<sup>85</sup> *Sylvia Shipping Co Ltd v Progress Bulk Carriers Ltd* [2010] C.L.C. 470. Most recently, this view was confirmed in *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146 para 74.

<sup>86</sup> *John Grimes Partnership Ltd v Gubbins* [2013] EWCA Civ 37 para 24.

<sup>87</sup> Para 24.

Lord Hoffmann also conceded that cases where the assumption of responsibility test will change the outcome of the traditional contemplation inquiry would be “highly unusual”.<sup>88</sup>

The immediate impact of the new test does not seem to entail a large shift in how risk for losses caused by breach will be allocated, therefore. It is also not controversial that, where parties agree to do so, the effects of default rules of law (such as the reasonable contemplation test) may be altered.<sup>89</sup>

What is controversial, however, is the extent to which it is possible to identify an implicit allocation of risk by parties in the cases where the express terms of the contract make no such allocation. The agreement-centred approach to remoteness put forward in *Achilleas* assumes that it is always possible to identify an implicit allocation of risk. This is contentious.

The debate around the accuracy of this conceptualisation seems especially important in a South African context where liability for special damages is currently based on agreement in the form of the convention requirement.<sup>90</sup> A brief overview of the debate will be provided in the next section.

## **5 4 The debate about an agreement-centred approach to remoteness of contractual damages**

### **5 4 1 The intention of the parties as the basis of remoteness**

The strongest and most prominent argument put forward in support of an agreement-centred approach to remoteness is that parties do contemplate breach and the consequences of breach at contract conclusion. Consequently, the argument goes, it will be unfair to disregard parties’ intentions. If remoteness is approached as a default

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<sup>88</sup> *Transfield Shipping Co Ltd v Mercator Shipping Inc, the Achilleas* [2009] 1 A.C. 61 67. It was also confirmed in *Sylvia Shipping Co Ltd v Progress Bulk Carriers Ltd* [2010] C.L.C. 470 479 that cases where the assumption of responsibility test will broaden or narrow the liability imposed by the reasonable contemplation test will be exceptional and rare.

<sup>89</sup> Winterton *Money Awards in Contract Law* 236.

<sup>90</sup> Ch 2 (2 5 2 2).

rule of law that operates outside of the parties' intentions, it will not be sufficiently sensitive to parties' reasonable expectations.<sup>91</sup>

There are academics who argue that it is simply not true that parties only contemplate the performance and not the breach of a contract at its conclusion.<sup>92</sup> Even if breach of contract is the exception and not the rule, it is a very expensive exception and one that is clearly contemplated by parties as can be seen in limitation and exclusion clauses.<sup>93</sup> Therefore,

"it is just not credible to assume that commercial parties draft toward performance but ignore breach in ways that justify more vigorous judicial intervention on remedial questions."<sup>94</sup>

When a defendant enters into a contract, he agrees to be bound to a contract which reflects a balance of risks and rewards. The limits of his responsibility should therefore be set with reference to what he can be taken to have accepted.<sup>95</sup>

Some proponents of the agreement-centred approach even argue that it is not necessary for parties to have intended to assume an obligation to pay damages. Rather, they argue that every obligation has a certain *orientation* toward specific consequences and that the risks for such consequences are allocated within the contract.<sup>96</sup>

The argument is therefore that every agreement reflects interests that it aims to protect and further. Losses that relate to these interests are considered to be recoverable.<sup>97</sup>

This view was also supported by Professor Dawson:

"just as a promisor's primary obligation is best explained as flowing from the promisor's assent to be bound, so the promisee's right to recover damages for breach of contract... is

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<sup>91</sup> Kramer "An Agreement-Centred Approach to Remoteness" in *Comparative Remedies* 256.

<sup>92</sup> Epstein "Beyond Foreseeability" in *Liability and Responsibility* 94.

<sup>93</sup> Kramer "An Agreement-Centred Approach to Remoteness" in *Comparative Remedies* 255-256.

<sup>94</sup> Epstein "Beyond Foreseeability" in *Liability and Responsibility* 95.

<sup>95</sup> J Cartwright "Remoteness of Damage in Contract and Tort: A Reconsideration" (1996) 55 *Cambridge L J* 488 505.

<sup>96</sup> Kramer "An Agreement-Centred Approach to Remoteness" in *Comparative Remedies* 257.

<sup>97</sup> 259.

best viewed as the enforcement of a consensual obligation... assented to by the defaulting promisor at the time of entering into the agreement.”<sup>98</sup>

Critics of this argument hold that parties contemplate performance and not breach at contract conclusion.<sup>99</sup> Although it would be possible for parties to contemplate breach when they conclude their contract, opponents of the agreement-centred approach simply argue that this will not *always* be the case.<sup>100</sup> Specifically, because remoteness questions usually concern consequences that are not fundamental or obvious at contract conclusion, it is argued that parties do not always intend a reciprocal allocation of risk. Consequently, courts cannot determine liability for damages solely with reference to the contract itself.

This conclusion is further supported with reference to the uncertainty that exists about the level of foreseeability of harm that would render damages recoverable. If apparently reasonable persons cannot agree on the degree of foreseeability needed for liability to be imposed, it seems farfetched to argue that foresight of breach should have resulted in an implied term (a tacit term in the South African sense) governing liability for damages in the contract.<sup>101</sup> If parties were very unlikely to have the same idea about the level of foreseeability at which losses become recoverable, how could they be in tacit agreement on the issue?

Although it seems alluring to explain the question of remoteness of damages with reference to parties' intentions, there is a point where they in fact did not agree anything and it is left to default rules of law to allocate risk for consequences of breach.<sup>102</sup>

#### 5 4 2 The determination of the intentions of parties

The second argument raised against an agreement-centred approach to remoteness in contract is that, even if it can be accepted that parties always intend some sort of

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<sup>98</sup> J Dawson “Reflections on Certain Aspects of the Law of Damages for Breach of Contract” (1995) 9 *JCL* 125 125.

<sup>99</sup> McGregor *Damages* 208-209.

<sup>100</sup> A Robertson “The Basis of the Remoteness Rule in Contract” (2008) 28 *LS* 172 179.

<sup>101</sup> Winterton *Money Awards in Contract Law* 239.

<sup>102</sup> 172.

reciprocal risk allocation for all losses that might occur, these intentions are not easily discovered. In essence, the argument holds that there is no reliable proxy for tacit intentions relating to remoteness of damages.<sup>103</sup> This is because, in questions of remoteness,

“we are not concerned with the interpretation of language and behaviour, but with an attempt to discern an allocation of risk from the nature of the contract and the factual matrix in circumstances where the parties have remained entirely silent on the allocation of risk.”<sup>104</sup>

In short, determining the consequences of a contract with reference to its construction has limits. Peel points out that these limits have led to the rejection of the implied term theory in explaining when a contract is void for mistake or discharged for frustration, for example.<sup>105</sup> Although it seems acceptable that a focus on the intentions of parties might have value in certain cases, it cannot be seen as the exclusive basis of remoteness.

Authors have also criticised the idea that the reasonable contemplation test serves as a rule of thumb for parties' intentions.<sup>106</sup> Rather, the reasonable contemplation test is very pertinently not concerned with the parties' intentions. It asks what a party could have foreseen given his knowledge at the time of contracting, and then assumes a process of contemplation that is very unlikely to have actually occurred.<sup>107</sup> The reasonable contemplation test therefore provides a mechanism for distributing *unallocated* risks.<sup>108</sup>

#### 5 4 3 Fairness

Proponents of the agreement-centred approach have argued that it is more fair towards a defendant to limit his liability with reference to the risk allocation that was presumably agreed to by the parties. They argue that the reasonable contemplation test will often be too harsh on a defendant.<sup>109</sup>

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<sup>103</sup> Robertson 2008 LS 179.

<sup>104</sup> 179.

<sup>105</sup> Peel *Law of Contract* 1058.

<sup>106</sup> Winterton *Money Awards in Contract Law* 241.

<sup>107</sup> Robertson 2008 LS 173.

<sup>108</sup> 173.

<sup>109</sup> A Burrows *Remedies for Torts and Breach of Contract* 3 ed (2004) 95.

The rebuttal raised against this is that, because the reasonable contemplation test is a default rule, parties can exclude it if they want to.<sup>110</sup> The reasonable contemplation test is arguably therefore not unfair – rather, its predictability and the possibility of excluding it make it fair.

There have also been arguments put forward that the assumption of responsibility test is unfair and harsh. This is because the test relies on implausible assumptions about what parties consider when they negotiate contracts. It is unlikely that parties negotiate while considering every possible consequence of breach in a way that would allow an impartial observer to objectively ascertain what extent of responsibility had been assumed.<sup>111</sup>

Indeed, it is argued that fairness would require a balancing of all the interests that are at stake, and that this cannot be done if a court ultimately only seeks to ascertain and yield to the parties' intentions.<sup>112</sup> In other words,

“the justice of the remoteness rule is not based on the notion that a defendant undertook responsibility for the risk in question, but on a concern that the defendant should have a reasonable opportunity to consider the risks that might arise from a breach and take action to avoid them.”<sup>113</sup>

It would seem therefore that the assumption of responsibility test has fallen into some of the same traps that have led to criticism of the reasonable contemplation test. It might be too restrictive in focus to always lead to fair results. Regardless of its strengths and weaknesses, the debate it has ignited about the role of the intentions of parties in determining the limits of liability for damages is an important one – also in South Africa.

## 5.5 Conclusion

As we have seen earlier in the overview of the South African position on remoteness in contract, there are two main issues at the heart of the dissatisfaction with the current

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<sup>110</sup> Andrews et al *Contractual Duties* 443.

<sup>111</sup> Harris 2012 *JCL* 135.

<sup>112</sup> 142.

<sup>113</sup> Robertson 2008 *LS* 172.

approach.<sup>114</sup> The first is the strict distinction between general and special damages, and the second is the controversy surrounding the convention principle. With both these issues, there is much to gain from an overview of English law.

The first conclusion that can be drawn is that there might be value in abandoning the distinction between general and special damages. English courts do not approach the determination of these two types of damages as involving two mutually exclusive tests. By contrast, South African law first determines whether losses suffered can be considered to be "general" or "special" before turning to the test for remoteness. This is problematic because

"[it] requires one to embark on an unnecessary, unhelpful and largely circular categorisation of loss as being either general or special. In truth, one shades into the other."<sup>115</sup>

What we can see from the discussion in this chapter, specifically from the *Victoria Laundry* decision, is that it might be preferable not to fixate on the distinction between general and special damages. All losses that occur naturally will be deemed foreseeable based on the knowledge that every person is taken to have of the natural and normal course of events. As the occurrence of the loss in question becomes less "normal", it will only be considered foreseeable based on a person's knowledge of circumstances that render that loss likely to occur. As a defendant's knowledge increases, so does his liability.

The test is therefore the same: reasonable foreseeability – based either on deemed or actual knowledge. Our emphasis on a strict distinction between the two types of losses might have hampered the fair application of the essential test that is relevant in both cases – foreseeability.

The second controversial aspect of the South African approach to remoteness is the convention principle. As we have seen previously, the convention principle is generally considered to have been established as part of South African law in the decision of *Lavery & Co Ltd v Jungheinrich*<sup>116</sup> ("*Lavery*"). In terms of the convention principle, special damages – compensation for losses that do not occur in the normal course of

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<sup>114</sup> Ch 2 (2 5 3).

<sup>115</sup> Burrows *Breach of Contract* 85.

<sup>116</sup> 1931 AD 156.

events – can only be recovered if it can be proven that the contract in effect contained an express or tacit term that the defendant would be liable for such damages.<sup>117</sup> In a less strict formulation of the convention principle it is only required that parties entered into the contract in view of the special circumstances which render the loss in question reasonably foreseeable. In terms of both these formulations it is clear, however, that the intention of the parties is central to the remoteness inquiry.<sup>118</sup>

The *Lavery* decision was based upon earlier case law on the issue of remoteness of special damages<sup>119</sup> which formulated a convention requirement with MacKeurtan as primary authority.<sup>120</sup> When MacKeurtan formulated his opinion that “the origin of special damages is conventual”,<sup>121</sup> he was relying on English decisions that, soon after *Hadley*, interpreted the reasonable contemplation test to require an agreement between parties that the defendant would be liable for special damages.<sup>122</sup>

As we have seen, however,<sup>123</sup> this idea was soon rejected in England. Rather, it was firmly established that the remoteness rules operate outside of the agreement and are not dependent on parties’ intentions. English law therefore decisively set out on a track where remoteness was not concerned with the intentions of parties while South African law made the recovery of special damages dependent upon those intentions.

It is interesting, therefore, to contrast the criticism that has been raised in South Africa against our convention principle (and in favour of moving away from parties’ intentions), whilst looking at the English move towards parties’ intentions with the assumption of responsibility test.

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<sup>117</sup> SWJ van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 362; *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 177.

<sup>118</sup> *Shatz Investments (Pty) Ltd v Kalovyrtas* 1976 2 SA 545 (A) 552.

<sup>119</sup> *Lazarus Bros v Davies & Kamann* 1922 OPD 88.

<sup>120</sup> HG MacKeurtan *The Sale of Goods in South Africa* (1921) 364.

<sup>121</sup> 364.

<sup>122</sup> *British Colombia v Nettleship* (1868) LR 3 CP 499; *Horne v Midland Railway* (1873) LR 7 CP 583.

<sup>123</sup> Ch 5 (5 2).



In South Africa, even though our courts have confirmed that the convention principle is still part of our law,<sup>124</sup> it has been heavily criticised.<sup>125</sup> It has also been acknowledged that the convention principle is not in accordance with the common law or with the authorities on which our test of remoteness was based.<sup>126</sup> It has been labelled by some academics as artificial, theoretically inaccurate and without practical use.<sup>127</sup> Furthermore, it has been put forward that the obligation to pay damages for breach of contract arises out of the act of breach and not the contract itself, rendering the agreement of the parties on the issue of remoteness irrelevant.<sup>128</sup> It seems therefore that the convention principle, and with it the idea that the recoverability of special damages is determined with reference to parties' intentions, has been largely discredited and is likely to be rejected by our courts when the opportunity arises.<sup>129</sup>

Against this backdrop, the shift in English law towards an agreement-centred approach to remoteness and the debate about the correctness of that change in position is noteworthy. In the overview that this chapter has provided, it can be seen that the debate around the agreement-centred approach to remoteness in contract

“seems to be reducible to a disagreement regarding just how far it is possible to push the objective theory of contractual interpretation. The disagreement, in other words, concerns whether at the time of contract it can be said that a reasonable person in the breaching party's position would have understood the content of his contractual undertaking to be either to perform or to compensate the other party for a certain amount of the loss that results from not performing.”<sup>130</sup>

From the discussion above it is clear that there is no definitive answer to this question in English law. It seems unlikely that it can be concluded that the parties will always reach an agreement on liability for damages.<sup>131</sup> It is even more unlikely from a South African perspective, where specific performance is contemplated as the primary

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<sup>124</sup> *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 580B.

<sup>125</sup> Lubbe & Murray *Contract – Cases, Materials, Commentary* 3 ed (1988) 624-625.

<sup>126</sup> JH Conradie *Die “Convention” en “Contemplation” – Beginsels by Skadevergoeding en Kontrakbreuk* LLM thesis University of the Free State (1987) 113.

<sup>127</sup> JC de Wet & AH van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* I 5 ed (1992) 227.

<sup>128</sup> 227.

<sup>129</sup> RH Christie & GB Bradfield *The Law of Contract in South Africa* 6 ed (2011) 577.

<sup>130</sup> Winterton *Money Awards in Contract Law* 236.

<sup>131</sup> 239.

remedy for non-performance and *not* damages. It is arguable therefore that the conclusion should be that the intentions of parties do not and ought not to lie at the heart of the remoteness inquiry.

However, even if there is an argument to be made in favour of some recognition for the intentions of parties (and more specifically the intention to be liable for damages) in the remoteness inquiry, the recent developments in English law serve to illustrate that the convention principle as it currently stands in our law is ill-equipped to do this.

The requirement that intentions with regard to liability for damages must be “virtually a term in the contract”<sup>132</sup> is insufficiently flexible. This criticism was also raised in England: authors argue that the objective theory of interpretation cannot be stretched that far.<sup>133</sup> Very often there simply will not be a tacit term regarding the allocation of risk for damages in the contract.

However, the debate in England has added some much-needed insight into the approach we could follow when determining remoteness in the context of parties’ intentions. What we see in the work of Adam Kramer and others is the notion that every contractual term has some general orientation, that it seeks to promote certain interests, or serve a certain purpose.<sup>134</sup>

English courts might have been incorrect in trying to reduce these aspects to tacit terms of the contract, but there is value in incorporating them into the remoteness inquiry. This is also what we have seen with the *Schutzzwecklehre* – an emphasis on the purpose of a breached provision and the interests that the provision sought to protect. Arguably, taking these aspects into account could contribute to a more fair and robust approach to remoteness.

In this chapter we have seen a tug of war between two conceptions of remoteness. The debate is framed as a trade-off between remoteness as a tool to discern parties’ intentions about the risk allocation for damages, or alternatively as a default rule which operates when parties did not agree upon anything. Arguably, the answer to the

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<sup>132</sup> *Lavery & Co Ltd v Jungheinrich* 1931 AD 156 176.

<sup>133</sup> Robertson 2008 LS 176-180.

<sup>134</sup> Kramer *Contract Damages* 291.

question of the appropriate test for remoteness does not lie at either extreme but rather somewhere in between depending on the context. It is for this reason that a more flexible approach to foreseeability might be needed.

The lesson to be learnt could be that our struggles to find a satisfactory single rule for remoteness inquiries have been unsuccessful precisely because there is no one such rule. This idea will be further explored in the concluding chapter of this dissertation. Before doing so, the foreseeability test as developed in the model instruments will be analysed in the next chapter to illustrate the possibilities of a more flexible approach to foreseeability.



## CHAPTER 6: THE FORESEEABILITY THEORY: THE MODEL INSTRUMENTS

### 6 1 Introduction

The preceding chapters of this study explored three alternative theories of remoteness in contract and highlighted the insights to be gained from those approaches. The origins, development and application of both the direct consequences and adequate cause theories have been discussed – and their strengths and weaknesses were identified. Against this background, the previous chapter focussed on the theory applied in South African law of contract: the foreseeability theory.

From the discussion of the application of the foreseeability theory in English law, we have gained insights into possible ways in which it could be developed in the South African context. However, the previous chapter has also identified weaknesses in the English approach to the foreseeability theory, such as the recent adoption of the so-called “assumption of responsibility” test. In an attempt to avoid some of the negative consequences of the traditional foreseeability test, English courts adopted a new test that treats foreseeability as a proxy for parties’ intentions. This is problematic, as has been discussed.<sup>1</sup> In the search for possible future developments of the South African approach to foreseeability, it may therefore be helpful to turn to other applications of the theory for insights.

This chapter seeks to investigate another approach to foreseeability – the approach adopted in model instruments that aim at regulating international commercial law. This may prove to be a worthwhile inquiry, especially because international instruments have faced the challenge of formulating an approach to remoteness in contract that can be applied across different jurisdictions. The process of drafting the international instruments has been concerned with the identification of common principles shared between countries with different approaches to remoteness.<sup>2</sup>

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<sup>1</sup> Ch 5 (5 4).

<sup>2</sup> B Zeller *Damages Under the Convention for Contracts for the International Sale of Goods* (2005) 2.

The result, as will be seen below, is arguably a renewed focus on the core rationale underlying the foreseeability theory. This rationale seems to be simply that parties should only be liable for risks that they could reasonably have taken into account when entering into a contract. This understanding has led to the development of a more flexible approach to foreseeability that could possibly avoid the weaknesses of the different individual approaches we have explored thus far.

The next section provides a brief overview of the model instruments and the foreseeability provisions that they have incorporated. This will be followed by a more detailed exposition of how the foreseeability test is applied under the model instruments. As we shall see, the approach they follow could potentially result in a foreseeability test that is better able to deal with the facts and circumstances of a particular case.

## **6 2 Overview of remoteness in the model instruments**

### **6 2 1 ULIS, ULFS and the CISG**

#### *6 2 1 1 Historical background*

Amongst the first instruments aimed at harmonising the rules governing international contracts (specifically in the context of the sale of goods) were ULIS<sup>3</sup> and ULFS.<sup>4</sup> These instruments were the result of more than thirty years' work and negotiations. In 1930, UNIDROIT<sup>5</sup> founded a drafting committee of scholars with the aim of developing a draft uniform law of sales.<sup>6</sup> A protracted drafting process resulted in the adoption of ULIS and ULFS at the Hague Conference in 1964.<sup>7</sup>

One of the prominent influences on the foreseeability provisions that were eventually codified in Articles 82 and 86 of ULIS was the work of Ernst Rabel. His comprehensive

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<sup>3</sup> Uniform Law on the International Sale of Goods (adopted 1 July 1964, entered into force 18 August 1972) 834 UNTS 108 (ULIS).

<sup>4</sup> Uniform Law on the Formation of Contracts for the International Sale of Goods (adopted 1 July 1964, entered into force 23 August 1972) 834 UNTS 170 (ULFS).

<sup>5</sup> International Institute for the Unification of Private Law.

<sup>6</sup> J Honnold "The Uniform Law for the International Sale of Goods: The Hague Convention of 1964" (1965) 30 *Law & Contemp Probs* 326 326-327.

<sup>7</sup> 326.

comparative study on sales law, *Das Recht des Warenkaufs*,<sup>8</sup> was instrumental in the drafting of an international sales law.<sup>9</sup> In his study of remoteness of damages in contract, he discussed the foreseeability theory as it had developed in France and England,<sup>10</sup> and in later works he also considered foreseeability provisions adopted in American law, as reflected in the Uniform Sales Act.<sup>11</sup>

Rabel argued that remoteness in contract should be determined with reference to the (presumed or actual) intentions of the parties to the contract. In this regard he praised the American and English adoption of foreseeability as a limit on contractual damages:

“I think that the English and American Courts remained truer to the ancient approach to contract law than continental judges and authors in so far as they never ceased to ask what the intention of the party was, and, where no intention could be found, what the parties would have intended had they foreseen this contingency.”<sup>12</sup>

With this approach as the point of departure, he formulated the principle that later formed the basis of the *Schutzzwecklehre* in Germany:<sup>13</sup>

“Ideas expressed by American courts and writers make me feel the best theory to be the following one: it depends on the *sense* and *scope* of the contract, what *interests* the creditor should have been warranted by the promise, and that these interests and no others, in case of breach of contract, ought to be protected by “concrete” (i.e. special) damages.”<sup>14</sup>

In this regard he criticised the adequate cause test as being too objective.<sup>15</sup> Rabel also conceded that tests to determine the parties’ intentions are “defective and often

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<sup>8</sup> E Rabel *Das Recht des Warenkaufs- Eine Rechtsvergleichende Darstellung I* (1936).

<sup>9</sup> P Schlechtriem *Uniform Sales Law: The UN Convention on Contracts for the International Sale of Goods* (1986) 16.

<sup>10</sup> Rabel *Das Recht des Warenkaufs* 491-497.

<sup>11</sup> E Rabel “A Draft of an International Law of Sales” (1938) 5 *U Chi L Rev* 543 554, with reference to the Uniform Sales Act of 1906.

<sup>12</sup> 554.

<sup>13</sup> The principle that the limits of damages should be determined with reference to the protective scope of the breached provision was set out by Rabel in “Die Grundzüge des Rechts der unerlaubten Handlungen” (1932) *Deutsche Ref. Int. Kong. Rechtsvergl.* as cited in HLA Hart & T Honoré *Causation in the Law* 2 ed (1985) 476.

<sup>14</sup> Rabel 1938 *U Chi L Rev* 555, (emphasis and parenthesis in original).

<sup>15</sup> 555. This criticism was shared by several German scholars, as we have seen previously in Ch 4 (4 3).

fictitious”.<sup>16</sup> Therefore, he expressed his approval for a foreseeability test that seeks to determine what a reasonable person with the knowledge of the parties in question would have foreseen, had he applied his mind.<sup>17</sup> He described the test as having a “much better foundation”<sup>18</sup> than the alternative adequate causation test. He hailed the foreseeability limit on damages as included in the 1956 draft of ULIS as a “striking practical gain”<sup>19</sup> for International Sales Law.

Rabel's approval for foreseeability as a limit on contractual damages seems generally to have been shared amongst the drafters. At the first committee discussion on the issue an English delegate suggested foreseeability as the proper limit on damages.<sup>20</sup> Later, this position was clarified. It was stated that a party's liability for contractual damages is rooted in the fact that he should have been aware of the possibility of a particular harm given his knowledge and the circumstances.<sup>21</sup>

#### *6 2 1 2 The foreseeability provisions in ULIS and the CISG*

ULIS draws a distinction between damages in cases where a contract was avoided (cancelled), and damages in cases where the contract was not avoided. In both instances, however, the limits of liability would be determined with reference to the foreseeability of the losses.<sup>22</sup> In cases where a contract was not avoided, Article 82 provides:

“... [D]amages for a breach of contract by one party shall consist of a sum equal to the loss, including loss of profit, suffered by the other party. Such damages shall not exceed the loss which the party ought to have foreseen at the time of the conclusion of the contract, in the

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<sup>16</sup> 554.

<sup>17</sup> 554.

<sup>18</sup> 555.

<sup>19</sup> E Rabel “The Hague Conference on the Uniform Sales Law” 1 (1952) *Am J Comp L* 58 63.

<sup>20</sup> F Faust *Die Vorhersehbarkeit des Schadens gemäß Art. 74 Satz 2 UN-Kaufrecht (CISG)* (1996) 51 as cited in N Altwater “Possible Consequences” as contained in Article 74 of the Convention on Contracts for the International Sale of Goods (CISG): *Friend or Foe?* (2007) unpublished paper in the Osgoode Hall Law School of York University available at: <[https://works.bepress.com/norbert\\_altwater/](https://works.bepress.com/norbert_altwater/)> (accessed 9-8-2016).

<sup>21</sup> 55.

<sup>22</sup> V Knapp “Section II – Damages Article 74” in CM Bianca & MJ Bonell *Commentary on the International Sales Law – the 1980 Vienna Sales Convention* (1987) 538 538.



light of the facts and matters which were then known or ought to have been known to him, as a possible consequence of the breach of contract.”<sup>23</sup>

Where a contract had been avoided, Article 84 provides that damages would be equal to the difference between the contract price and the current market price for the performance not delivered.<sup>24</sup> Article 85 allows for cases where there is no such market price, in which case a reasonable substitute should be used.<sup>25</sup> In terms of remoteness in these cases, Article 86 of ULIS provides:

“The damages referred to in Article 84 and 85 may be increased by the amount of any reasonable expenses incurred as a result of the breach or up to the amount of the loss, including loss of profit, which should have been foreseen by the party in breach, at the time of the conclusion of the contract, in the light of the facts and matters which were known or ought to have been known to him, as a possible consequence of the breach of contract.”

Both ULIS and ULFS did not become widely recognised international sales law. Few countries ratified the conventions,<sup>26</sup> and their application was limited to transactions between parties of the member states. However, it was on the basis of these two conventions<sup>27</sup> that arguably the most successful international instrument dealing with international commercial contracts came into being – the CISG.<sup>28</sup>

The CISG was adopted on 11 April 1980 and entered into force on 1 January 1988. At the time of writing, it has been ratified by 84 states. Contracts between parties from any of these states will be governed by the CISG if the conditions for its applicability have been met,<sup>29</sup> and if its application has not been excluded by the parties.<sup>30</sup> The CISG is often referred to and applied by courts and arbitration tribunals,<sup>31</sup> and has

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<sup>23</sup> 82 ULIS.

<sup>24</sup> 84 ULIS.

<sup>25</sup> 85 ULIS.

<sup>26</sup> The conventions have been ratified by 9 states, two of which adopted the reservation which makes the law only applicable if elected by the parties – Schlechtriem *Uniform Sales Law* 17.

<sup>27</sup> Knapp “Damages” in *Commentary on the International Sales Law* 538.

<sup>28</sup> Zeller *Damages* 9.

<sup>29</sup> 1(1) CISG: “This convention applies to contracts of sale of goods between parties whose places of business are in different States.”

<sup>30</sup> Pace Law School Institute of International Commercial Law “CISG: Table of Contracting States” (8-01-2016) CISG <<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>> (accessed 24-01-2016).

<sup>31</sup> D Saidov *The Law of Damages in International Sales – the CISG and other International Instruments* (2008) 3.

influenced the drafting of other conventions as well as the revision of certain domestic contract laws.<sup>32</sup> It has also been affirmed as the most widely accepted international instrument on contracts for the sale of goods.<sup>33</sup>

Unlike ULIS, the CISG does not incorporate the distinction between contracts that have been cancelled and those that have not. Its provision on the limitation of contractual damages corresponds, however, to Article 82 of ULIS.<sup>34</sup> The two provisions are considered substantively identical by the Secretariat Commentary to the CISG.<sup>35</sup> Article 74 of the CISG provides:

“Damages for breach of contract by one party consists of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which he then knew or ought to have known, as a possible consequence of the breach of contract.”<sup>36</sup>

Article 74 is one of the CISG provisions most written and litigated about.<sup>37</sup> Because of the rich body of literature and decisions on Article 74, its wide acceptance, and the fact that it formed the basis of the foreseeability tests we see in other instruments, it will be the main focus of section 3 below. Before dealing with the application of the foreseeability test under Article 74, a brief overview will be provided of the other important model instruments.

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<sup>32</sup> Zeller *Damages* 9. Zeller makes specific mention of Estonian and Chinese contract law that have been revised based on the CISG.

<sup>33</sup> International Institute for the Unification of Private Law “Art. 1.6(2) UNIDROIT Principles” (2010) xxiii.

<sup>34</sup> Knapp “Damages” in *Commentary on the International Sales Law* 538.

<sup>35</sup> “Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat” (“Secretariat Commentary”) (14 March 1979) UN Doc A/CONF 97/5 59. The Secretariat Commentary is considered the closest counterpart to an official commentary to the CISG.

<sup>36</sup> 74 CISG.

<sup>37</sup> J Gotanda “Awarding Damages under the United Nations Convention on the International Sale of Goods: A Matter of Interpretation” (2005-2006) 37 *Geo J J Int'l L* 95 95.

## 6 2 2 UNIDROIT PICC

The PICC<sup>38</sup> was first published in 1994 with the purpose of “establish[ing] a balanced set of rules designed for use throughout the world irrespective of the legal traditions and economic and political conditions of the countries in which they are applied”.<sup>39</sup> It was intended, in other words, to become the soft law of international commercial contracts.<sup>40</sup> Its application has a wider scope than the CISG because it is not restricted to any particular type of contract, such as sale.

Article 7.4.4 of the PICC governs remoteness in contract and holds that:

“[t]he non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its performance.”<sup>41</sup>

It must be noted that, where the model instruments refer to non-performance, this equates to the South African understanding of breach of contract in general.

Despite striking similarities, this provision is not identical to Article 74 of the CISG.<sup>42</sup> It seems as if the provision that a defendant will be liable for harm which he “could have foreseen” is less strict than the CISG provision imposing liability for harm which he “ought to have foreseen”. Authors have also pointed out that “could have foreseen” is a more preferable formulation of the test, because “ought” implies a duty on a defendant to foresee harm, which is a peculiar concept.<sup>43</sup> A further difference is that harm must be foreseeable as “likely to result” from non-performance in order to be recoverable under the PICC. By contrast, the CISG requires only that harm was foreseeable as a “possible consequence” of the breach. It has been suggested that the PICC might therefore require harm to be foreseeable with a higher degree of

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<sup>38</sup> International Institute for the Unification of Private Law “UNIDROIT Principles of International Commercial Contracts” (2010).

<sup>39</sup> International Institute for the Unification of Private Law “Art. 1.6(2) UNIDROIT Principles” (2010) xxiii.

<sup>40</sup> S Vogenauer *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2015) 31-149.

<sup>41</sup> 7.4.4 PICC.

<sup>42</sup> E McKendrick “Article 7.4.4” in S Vogenauer *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2015) 993.

<sup>43</sup> R Zimmermann “Limitation of Liability for Damages in European Contract Law” (2014) 18 *Edin L Rev* 193 205.

probability than under the CISG, causing it to restrict liability more than the CISG would.<sup>44</sup>

However, it is unlikely that the foreseeability test contained in PICC will be interpreted differently from Article 74 CISG.<sup>45</sup> No difference in substance seems to have been intended by the drafters of the PICC,<sup>46</sup> since their official comments state that Article 7.4.4 corresponds to Article 74 CISG.<sup>47</sup>

### 6 2 3 PECL

Another instrument aimed at creating non-binding soft law that could inter alia promote the harmonisation of contract law was created in 2002, this time specifically aimed at European contract law: the PECL.<sup>48</sup> When dealing with the issue of remoteness in contract, Article 9:503 PECL provides:

“The non-performing party is liable only for loss which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as a likely result of its non-performance, unless the non-performance was intentional or grossly negligent.”<sup>49</sup>

One marked difference between this provision and the CISG is that the PECL distinguishes between cases where there was fault in the form of intent or gross negligence on the side of the defendant and cases where these forms of fault are absent - similar to the position in French law.<sup>50</sup> Apart from the Draft Common Frame of Reference (DCFR),<sup>51</sup> this limitation of liability based on certain forms of fault of the defendant is not found in other instruments.

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<sup>44</sup> McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 995.

<sup>45</sup> Saidov *Damages in International Sales* 104.

<sup>46</sup> O Lando “Foreseeability and Remoteness of Damages in Contract in the DCFR” (2009) *E R P L* 619 620.

<sup>47</sup> UNIDROIT “Official Comments on the PICC” (2010) *UNILEX* <<http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13637>> (accessed 15-01-2016)

<sup>48</sup> European Union, Commission on European Contract Law “Principles of European Contract Law, Parts I and II (Completed and Revised)” (6 May 1994).

<sup>49</sup> 9:503 PECL.

<sup>50</sup> See Ch 2 (2 3 3 1).

<sup>51</sup> C von Bar, E Clive & H Schulte-Nölte (eds) *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (2009).

It has been suggested that such a limitation would be strange in a system where liability for breach of contract does not depend on fault,<sup>52</sup> because there is also no necessary relation between a defendant's fault and the foreseeability of damage.<sup>53</sup> The focus of this chapter will therefore fall on the application of the foreseeability test under the model instruments, without further reference to the possible impact of the fault of the defendant on the limits of liability.

#### 6 2 4 Other instruments

In addition to the PECL and the PICC, foreseeability can be regarded as a shared premise across a number of instruments.<sup>54</sup> Article 161 of the European Commission's now shelved "Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law" (CESL)<sup>55</sup> provides that:

"[t]he debtor is liable only for loss which the debtor foresaw or could be expected to have foreseen at the time when the contract was concluded as a result of the non-performance."<sup>56</sup>

As we have seen previously, there is a suggested difference in the scope of the foreseeability test between instruments that require loss to be foreseen as a "likely"<sup>57</sup> result of breach, in contrast to those requiring loss to be foreseen as only a "possible"<sup>58</sup> consequence of breach.<sup>59</sup> The CESL, however, does not incorporate any such terminology, and merely requires that damages must have been "foreseen... as a result of the non-performance".<sup>60</sup> In previous chapters, we have seen how the debate about an appropriately defined level of likelihood at which damages must have been

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<sup>52</sup> Zimmermann 2014 *Edin L Rev* 209.

<sup>53</sup> 209.

<sup>54</sup> S Eiselen "Art 74 CISG-UP" in J Felemegas (ed) *An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law* (2007) 211 212.

<sup>55</sup> (Brussels 11 October 2011) 2011/0284.

<sup>56</sup> 161 CESL.

<sup>57</sup> 7.4.4 PICC, 9:503 PECL, III 3:703 DCFR.

<sup>58</sup> 86 ULIS, 74 CISG.

<sup>59</sup> McKendrick "Article 7.4.4" in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 995; Zimmermann 2014 *Edin L Rev* 205.

<sup>60</sup> 161 CESL.

foreseeable has, in different jurisdictions and contexts, proven fruitless.<sup>61</sup> Against this background, the simplified formulation provided in the CESL might be an improvement. Arguably, the formulation of the CESL merely requires that a consequence of breach must have been foreseeable as possible at the time of contract conclusion.

A third difference is that the CESL does away with the word “reasonably”. It has been argued that this is the most preferable way to phrase the rule, because reasonableness would be implicit in an inquiry as to what a person ought to have foreseen.<sup>62</sup>

Article 161 CESL corresponds to Article III. – 3:703 of its precursor, the DCFR, which states that:

“The debtor in an obligation which arises from a contract or other juridical act is liable only for loss which the debtor foresaw or could reasonably be expected to have foreseen at the time when the obligation was incurred as a likely result of the non-performance, unless the non-performance was intentional, reckless or grossly negligent.”<sup>63</sup>

Again, we see that this instrument requires loss to have been reasonably foreseeable as a “likely” result of the breach, and not a “possible” result (as seen in Article 74 CISG). Although the former might suggest a stricter test than the latter, it does not seem that a difference in substance was intended.<sup>64</sup> The foreseeability limit on the recovery of damages formulated in this instrument “adheres to”<sup>65</sup> the foreseeability test in Article 74 CISG.

This chapter will not attempt to explore the nuanced differences between these instruments. Instead, its aim is to provide a succinct overview of how foreseeability has been treated in international contract law, with the purpose of gaining insight into the South African application of the foreseeability test. In order to contextualise the application of the foreseeability theory as seen under the model instruments, it is

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<sup>61</sup> Ch 4 (4 5), Ch 5 (5 2 2).

<sup>62</sup> Zimmermann 2014 *Edin L Rev* 205.

<sup>63</sup> III- 3:703 DCFR.

<sup>64</sup> Lando 2009 *ERPL* 620.

<sup>65</sup> 639.

necessary to understand how the rationale for the rule has been understood by drafters and scholars.

### 6 2 5 The rationale for the foreseeability theory

After considering the CISG drafting committee proceedings, Schlechtriem explains the rationale for the foreseeability rule in the CISG as follows:

“The underlying idea of the rule is that the parties, at the conclusion of the contract, should be able to calculate the risks and potential liability they assume by their agreement”<sup>66</sup>

In other words, there should be no liability for unforeseeable damages because:

“the non-performing party, in determining whether to enter into the contract, and, if so, on which conditions, whether to bargain for a limitation of liability, or to take out insurance, had not been able to take account of consequences of a non-performance which were not reasonably foreseeable.”<sup>67</sup>

This is confirmed by the Secretariat Commentary to the CISG where the effect of the rule is described as follows:

“Should a party at the time of the conclusion of a contract consider that breach of the contract by the other party may cause him exceptionally heavy losses or losses of an unusual nature, he may make this known to the other party with the result that if such damages are actually suffered they may be recovered.”<sup>68</sup>

The operating principle seems to be that a defendant, when he concluded a contract, could only have bargained with knowledge of risks that he reasonably could have foreseen. What he reasonably could have foreseen would be determined by his knowledge and the particular circumstances. For such reasonably foreseeable risks, he could have taken steps to avoid, minimise or insure against the risks or alternatively, he could have driven a harder bargain to compensate for the assumption of those risks. He would not have been in a position to do so for any unforeseeable

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<sup>66</sup> Schlechtriem *Uniform Sales Law* 96.

<sup>67</sup> Zimmermann 2014 *Edin L Rev* 206.

<sup>68</sup> 59.

risks, and should therefore not be held liable for them. Simply put, parties must be reasonably able to know what they are bargaining for.<sup>69</sup>

This understanding of the underlying rationale for the foreseeability theory is shared amongst international trade law scholars,<sup>70</sup> and the same rationale offered for Article 74 CISG was used when incorporating the foreseeability theory into other prominent international instruments.<sup>71</sup>

In light of this underlying rationale, the next section explores the operation of the foreseeability theory in the model instruments. This is done against the background of a brief discussion of the correspondence between the foreseeability theory in terms of English law with that of the model instruments. As will be seen, the understanding of the rationale for the foreseeability theory highlighted above has arguably allowed for a more flexible approach to foreseeability under the model instruments than what we have seen in terms of South African and English law.

### **6 3 The operation of the foreseeability theory in the model instruments**

#### **6 3 1 Correspondence with the foreseeability theory in English law**

As may be deduced from the overview of the relevant provisions above, the foreseeability test adopted by the model instruments functions similarly to the foreseeability test as discussed in the context of English law.<sup>72</sup>

Article 7 of the CISG explicitly provides that, in the interpretation of the Convention, “regard is to be had to its international character”<sup>73</sup>. This sentiment is also echoed in

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<sup>69</sup> C Liu *Remedies for Non-Performance: Perspectives from the CISG, UNIDROIT Principles & PECL* LLM Thesis Renmin University of China (2003) 396.

<sup>70</sup> U Magnus “Remedies: Damages, Price Reduction, Avoidance and Preservation” in LA DiMatteo *International Sales Law – A Global Challenge* (2014) 257 257.

<sup>71</sup> O Lando 2009 *E R P L* 621.

<sup>72</sup> McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Contracts (PICC)* 993.

<sup>73</sup> 7 CISG.



other instruments.<sup>74</sup> In principle, therefore, foreseeability under the model instruments should be determined without reference to domestic law.<sup>75</sup>

Despite this, many discussions of foreseeability in the model instruments refer to *Hadley v Baxendale*<sup>76</sup> (“*Hadley*”). It has also been admitted that, because of the seminal role that the *Hadley* decision played in the development of the foreseeability test, its interpretation of foreseeability has informed the formulation of Article 82 ULIS and Article 74 CISG.<sup>77</sup> The result is that the foreseeability test as set out in the model instruments will in many respects correspond to the foreseeability test set out in Chapter 5 of this study.

The key difference between foreseeability as understood in English and also South African law, and foreseeability under the model instruments, is that the latter approach to determining foreseeability is more flexible, and takes several different factors into account when determining whether or not damages were foreseeable. This will be considered later in the chapter. The operation of the foreseeability test, as well as its more flexible application, is explored in the next section.

## 6 3 2 Application of the foreseeability theory under the model instruments

### 6 3 2 1 *The knowledge of the defendant*

Article 74 CISG limits a defendant’s liability for contractual damages to those losses that he either did foresee, or those that he should have foreseen given the facts and

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<sup>74</sup> See 1:101(4) PECL, 1.6 PICC.

<sup>75</sup> *Zeller Damages* 16.

<sup>76</sup> *Hadley v Baxendale* [1854] 9 Ex 341. See for example: F Blasé & P Hötter “Remarks on Damages Provisions in the CISG (Article 74), Principles of European Contract Law (PECL), and UNIDROIT Principles of International Commercial Contracts (PICC)” in J Felemegas (ed) *An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law* (2007) 465 469; *Zeller Damages* 91; McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 993; J Gotanda “Article 74” in S Kröll, L Mistelis & PP Viscasillas (eds) *UN Convention on Contracts for the International Sale of Goods (CISG)* (2011) 990 992; I Schwenzer “Article 74” in I Schwenzer (ed) *Schlechtriem & Schwenzer – Commentary on the UN Convention on the International Sale of Goods (CISG)* 3 ed (2010) 999 1000; C Liu *Remedies in International Sales* (2007) 458.

<sup>77</sup> *Zeller Damages* 95.

matters that he knew about or should have known about.<sup>78</sup> This is determined with reference to the time of contract conclusion.<sup>79</sup> Damage which becomes foreseeable after contract conclusion will therefore not have any effect on the defendant's liability.<sup>80</sup>

In contrast to the positions in terms of English<sup>81</sup> and South African law,<sup>82</sup> Article 74 CISG and the other model instruments require that the losses are foreseeable only by the defendant. The question is therefore not what both parties foresaw or could reasonably have foreseen. This difference will not have much effect on the foreseeability inquiry in practice however,<sup>83</sup> because:

“In the case where loss is foreseeable to the aggrieved party, but not to the non-performing party, the aggrieved party should draw that loss to the attention of the non-performing party... If it does, the loss has been foreseeable to the non-performing party and is potentially recoverable. If he does not do so, or in the case where the loss was not foreseeable to either party, the non-performing party is not liable for the loss.”<sup>84</sup>

In terms of how one should go about determining whether loss was foreseeable at contract conclusion, the CISG requires foreseeability to be determined with reference to knowledge of facts and circumstances that would render those damages foreseeable. The foreseeability inquiry therefore revolves around a determination of the knowledge that a defendant had or ought to have had.

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<sup>78</sup> 74 CISG: “Damages for breach of contract by one party consists of a sum equal to the loss, including the loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he knew then or ought to have known, as a possible consequence of the breach of contract.”

<sup>79</sup> 765.

<sup>80</sup> Knapp “Article 74” in Bianca & Bonell *Commentary on the International Sales Law* 542.

<sup>81</sup> I Schwenzer “Article 74” in I Schwenzer (ed) *Schlechtriem & Schwenzer – Commentary on the UN Convention on the International Sale of Goods (CISG)* 3 ed (2010) 999 1019.

<sup>82</sup> See for example *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22: “Such damages are only awarded... as my reasonably be supposed to have been in the contemplation of *the contracting parties*” (emphasis added).

<sup>83</sup> D Saidov “Methods of Limiting Damages Under the Vienna Convention on Contracts for the International Sale of Goods” (2002) 14 *Pace Int'l L Rev* 307 311.

<sup>84</sup> McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 993. See also AL Corbin *Corbin on Contracts* 5 (1962) 1010, as cited in AG Murphey “Consequential Damages in Contracts for the International Sale of Goods and the Legacy of *Hadley*” (1989) 23 *Geo Wash J Int'l L & Econ* 415 435.

This suggests that the knowledge that a defendant is taken to have had at contract conclusion will be of two kinds.<sup>85</sup> First, such knowledge could be *actual* knowledge – the facts and circumstances that the defendant was aware of when he concluded the contract. This is a subjective test. Secondly, knowledge can be *imputed* – based on facts or circumstances that the defendant “ought to have known [about]”<sup>86</sup>. This will be determined objectively with reference to what a reasonable person can be expected to know about the facts and circumstances in a particular case.<sup>87</sup>

The more “usual” losses are – that is, the more it can be expected in the normal course of events – the more likely it is that knowledge of the facts and circumstances rendering those losses foreseeable will be imputed. As losses become more extraordinary and unusual, the less likely it is that it can be reasonably expected of a party to have had knowledge rendering those losses foreseeable. In such cases he would only be liable based on actual knowledge.

This idea that foreseeability is based on either actual or imputed knowledge, and that the one shades into the other as losses become more unusual, is very similar to the foreseeability test as explained in *Victoria Laundry (Windsor) LD v Newman Industries LD*<sup>88</sup> (“*Victoria Laundry*”) in English law,<sup>89</sup> where it will be recalled that the court held that both rules in *Hadley* rely on the same underlying principle. Under the first rule in *Hadley*, a defendant is deemed by law to have knowledge of all losses that would occur as a consequence of breach in the normal course of events. Under the second rule, a defendant will be liable for all losses that a reasonable person in his position, with his actual knowledge, would have foreseen. *Victoria Laundry* therefore held that the tests for subjective and objective knowledge are not analytically distinct, but rather that the one shades into the other as a defendant’s liability increases with his knowledge.<sup>90</sup>

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<sup>85</sup> Saidov *Damages in International Sales* 105.

<sup>86</sup> 74 CISG.

<sup>87</sup> Knapp “Article 74” in Bianca & Bonell *Commentary on the International Sales Law* 542.

<sup>88</sup> [1949] 2 K.B. 528 CA.

<sup>89</sup> See ch 5 (5 2 2).

<sup>90</sup> E Peel *The Law of Contract* 13 ed (2011) 1057.

### 6 3 2 2 *The extent of the damage*

When determining whether or not losses were foreseeable, the question inevitably arises as to what exactly must have been foreseen. Simply referring to “loss” or “harm” leaves it unclear whether the model instruments require foreseeability of only the nature of the harm or also of its extent. Some authors argue that the CISG requires foreseeability of both aspects.<sup>91</sup> It has also been suggested that Article 74 CISG, by using the words “may not exceed” in the phrase “damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract”<sup>92</sup> implies foreseeability of the extent of loss and not only the nature thereof.<sup>93</sup> This is because a loss of a particular nature cannot be “exceeded”. The comments to the PICC state:

“Foreseeability relates to the nature or type of harm but not to its extent unless the extent is such as to transform the harm into one of a different kind.”<sup>94</sup>

In other words, when the extent of loss is considerably more than what is reasonably foreseeable, it would be considered to be a different type of loss<sup>95</sup> – arguably because it ceases to be “usual” and becomes “unusual”. This would suggest, therefore, that it is not possible to completely exclude the extent of loss from an inquiry as to its foreseeability.

Requiring foreseeability of not only the nature or type of loss but also its extent seems to be a sensible approach. In English and South African law, foreseeability of only the nature of harm and not its extent is required. This leads to unsatisfactory results, as seen for instance in the case of *Transfield Shipping Inc v Mercator Shipping Inc, the Achilles*<sup>96</sup> (“*The Achilles*”) discussed in the previous chapter.<sup>97</sup>

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<sup>91</sup> Gotanda “Article 74” in *The UN Convention on the International Sale of Goods* 766.

<sup>92</sup> 74 CISG.

<sup>93</sup> Saidov *Damages in International Sales* 114.

<sup>94</sup> UNIDROIT “Official Comments on the UPICC” (2010) *UNILEX* <<http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13637>> (accessed 15-01-2016).

<sup>95</sup> Gotanda “Article 74” in *The UN Convention on the International Sale of Goods* 766.

<sup>96</sup> [2009] 1 A.C. 61.

<sup>97</sup> Ch 5 (5 3 1).

In this case the nature or type of harm was foreseeable, but its extent was excessive. The minority ruling of the case denied the recovery of damages because of the fact that the extent of harm was not foreseeable.<sup>98</sup> This was criticised as incorrect because the English foreseeability test does not require foreseeability of the extent of loss, only of its nature.<sup>99</sup> Essentially, the court faced a dilemma – the strict formulation of the foreseeability test (only requiring foreseeability of the nature of loss) would clearly not yield equitable results in the particular case.

The majority decision's solution to this problem was the imposition of the assumption of responsibility test.<sup>100</sup> As we have seen, this test for remoteness in contract focusses on the parties' presumed intentions regarding liability for damages. The test reformulated the role of foreseeability in questions of remoteness of contractual damages. Foreseeability of harm was no longer the primary underlying reason for limitations on contractual damages, but rather a tool to discover the "presumed intentions",<sup>101</sup> "assumed responsibility",<sup>102</sup> "shared understanding"<sup>103</sup> or "common expectations"<sup>104</sup> of the parties – which is, according to the majority decision, the correct limit on liability.

The problem with this approach is that it is essentially based on a fiction – as we have seen previously, there are many instances where parties simply do not have any intentions with regards to the limits of contractual damages.<sup>105</sup>

More importantly, this statement does not give effect to the underlying rationale of foreseeability as a limit on contractual damages discussed earlier in this chapter.<sup>106</sup> The correct idea seems to be that a defendant must reasonably be able to take into account risks of liability when concluding a contract. He would be liable for all damages that he could, had he acted reasonably, have taken into account. This implies that the

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<sup>98</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] A.C. 61 90.

<sup>99</sup> Peel *The Law of Contract* 1056.

<sup>100</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] A.C. 61 67.

<sup>101</sup> 71.

<sup>102</sup> 73.

<sup>103</sup> 83.

<sup>104</sup> 85.

<sup>105</sup> Ch 5 (5 4).

<sup>106</sup> Ch 6 (6 2 5).

test should not ask which risks he *did* take into account, or what parties had agreed upon in that regard – but rather whether he *could* have been able to take those risks into account if he had acted reasonably.

The solution in *Achilleas* is apparently to replace one rigidly defined test with another. The dilemma faced in the *Achilleas* decision arose simply because of the failure to recognise that questions of remoteness of damages and of foreseeability are “inevitably imprecise”.<sup>107</sup> This is especially true about the distinction between the *nature* and *extent* of a particular loss.<sup>108</sup>

The problematic nature of this distinction can be illustrated in cases where the plaintiff claims damages for lost profits. The nature of a loss (i.e. loss of profits) is generally foreseeable in commercial contracts. However, lost profits could be of such a large extent that a defendant would not reasonably have been able to foresee them. The question whether this changes the nature of the loss, and at which point it does, is not one that elicits obvious answers.

The problem is exacerbated by the fact that whether or not foreseeability relates to the nature or to the extent of a loss caused by breach of contract depends on our definition of the consequence of a particular breach. If the consequence is “loss of profits”, its nature could have been foreseen. If, however, we define the consequence as “loss of profits from especially lucrative commercial contracts”,<sup>109</sup> we could argue that the nature of the loss was unforeseeable. As seen previously,<sup>110</sup> this is similar to the situation that arose in the application of the adequate cause theory: any clinical test aiming at delineating the relationship between cause and consequence becomes imprecise and opaque when we have to decide how to define cause and consequence. This is also seen with the foreseeability theory: we can define any consequence in a broad (“lost profits”) or narrow (“loss of profits from lucrative contracts”) manner, and

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<sup>107</sup> Lando 2009 *ERPL* 620, citing EA Farnsworth “Damages and Specific Relief” (1979) 27 *Am J Comp L* 247 253.

<sup>108</sup> McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 993.

<sup>109</sup> As was done, for example, in *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 CA. In this regard, see McKendrick “Article 7.4.4” in *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 994-995.

<sup>110</sup> Ch 4 (4 2 2).

that would affect a conclusion as to whether we are dealing with foreseeability of the nature or of the extent of a loss. The extent of a loss is inextricably linked to its nature, and vice versa. The result seems to be that the remoteness inquiry cannot be definitively focussed on only one of the two.

The solution to the imprecise nature of the remoteness inquiry probably does not lie in a new conception of remoteness and a newly defined test to go along with it as was done in *Achilleas*. Rather, a workable test for remoteness in contract would have to be flexible enough to take several different factors into account, and would have to be decided upon the facts of each case. The foreseeability test as developed and applied under the model instruments seems well suited to do this.

The model instruments indicate that knowledge can be determined with reference to various different considerations, depending on the facts of each case. This is because, under the model instruments, what a party “ought to have known” is determined with reference to a variety of factors.

### 6 3 3 Flexible approach to the foreseeability theory

#### 6 3 3 1 *Rationale for a flexible approach to foreseeability*

As discussed earlier in this chapter,<sup>111</sup> the rationale for foreseeability as a limit on contractual damages in the model instruments is explained in terms of assumption of risk. That is, a defendant's liability for damages should be limited to those losses of which he could have foreseen the risk. He must reasonably have had the opportunity, therefore, to take the risk of such liability into account when entering into the contract – affording him the opportunity either to refuse the contract, negotiate for a higher contract price, insure against the risk, or take steps to minimise such risk. If a defendant did not reasonably have the opportunity to take risk of liability into account in that manner, he should not be liable. This view of the underlying rationale

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<sup>111</sup> Ch 6 (6 2 1).



for the foreseeability theory is shared by scholars<sup>112</sup> and the drafters of the model instruments.<sup>113</sup>

If we accept this as the correct reasoning behind the foreseeability test, it is also clear that there is a wide variety of factors and circumstances that influence what a defendant could have reasonably taken into account in a particular case. Arguably, the application of the traditional foreseeability test has not reflected an awareness of such factors and circumstances.

This has been discussed in the context of both the South African and English approach to foreseeability. In both these approaches, the knowledge which a defendant is taken to have had at contract conclusion is determined within a limited frame of reference. A defendant's presumed knowledge of the "usual course of things" is taken into account, and in addition to that any knowledge that he might have had of special circumstances which would render unusual losses foreseeable. In contrast to this, the model instruments determine foreseeability with reference to a number of additional factors. The official comments to Article 7.4.4 PICC, for example, state that

"[f]oreseeability is a flexible concept which leaves a wide measure of discretion to the judge."<sup>114</sup>

Under the model instruments, the foreseeability test is therefore applied with reference to a wide range of factors, including the scope and purpose of the contract in question,<sup>115</sup> the allocation of risk in the contract,<sup>116</sup> previous dealings between the

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<sup>112</sup> P Schlechtriem *Uniform Sales Law – The UN Convention on Contracts for the International Sale of Goods* (1986) 96; Zimmermann 2014 *Edin L Rev* 206; Magnus "Remedies: Damages, Price Reduction, Avoidance and Preservation" in DiMatteo (ed) *International Sales Law – A Global Challenge* (2014) 257; Liu *Remedies for Non-Performance* 396.

<sup>113</sup> "Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat ("Secretariat Commentary") (14 March 1979) UN Doc A/CONF 97/5 59. See also in this regard Lando 2009 *E R P L* 621.

<sup>114</sup> UNIDROIT "Official Comments on the UPICC" (2010) *UNILEX* <<http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13637>> (accessed 15-01-2016).

<sup>115</sup> C Liu *Remedies in International Sales – Perspectives from the CISG, UNIDROIT Principles and PECL* (2007) 461.

<sup>116</sup> Gotanda "Article 74" in *The UN Convention on the International Sale of Goods* 765.



parties,<sup>117</sup> established practices between the parties,<sup>118</sup> and common trade usage.<sup>119</sup> The next section explores some of these factors and how they are considered.

### 6.3.3.2 *Factors taken into account in the flexible approach*

The inquiry as to foreseeability under the model instruments has been approached in a manner that allows the facts of the case to determine which consideration will prove decisive. The inquiry of the court is

“to determine to what degree a reasonable person within the meaning of Art. 8(3)<sup>120</sup> CISG in the circumstances known to [the breaching party] at the time of the conclusion of the contract could (or should) foresee such [damage]”<sup>121</sup>

To do so, the court relies on an inquiry into the party’s “risk evaluation at the time of the conclusion of the contract”.<sup>122</sup> To this end, the various factors that courts have held to be indicative of foreseeability of harm have been applied in a flexible manner – depending on the facts of a particular case. This section explores some of these factors.

Often, courts refer to a party’s experience and commercial expertise when determining what that party could or ought to have foreseen.<sup>123</sup> Where the party is a trader in a particular market, courts will tend to assume that he ought to have known about prevailing prices in the market, as well as the tendencies of the market to be volatile.

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<sup>117</sup> Saidov *Damages in International Sales* 105.

<sup>118</sup> 8 CISG.

<sup>119</sup> 9 CISG.

<sup>120</sup> 8(3) CISG: “In determining the intent of a party or the understanding of a reasonably person would have had, due consideration is to be given to all relevant circumstances of the case including negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.”

<sup>121</sup> *Case 7 Ob 301/01t* (14 January 2002) Austrian Supreme Court <<http://cisgw3.law.pace.edu/cases/020114a3.html>> (accessed 18-04-2016).

<sup>122</sup> *Case 7 Ob 301/01t* (14 January 2002) Austrian Supreme Court <<http://cisgw3.law.pace.edu/cases/020114a3.html>> (accessed 18-04-2016)

<sup>123</sup> Knapp “Damages” in *Commentary on the International Sales Law* 542.

For example, in one case decided under ULIS, the court held that a buyer, by virtue of his commercial expertise, should have foreseen volatility in market price.<sup>124</sup>

Not only a party's commercial experience, but also his specific knowledge of an industry or product could inform an inquiry as to what he could have foreseen. In one such case, the delivery of a defective packaging system had caused the aggrieved party harm in the form of increased maintenance expenses. This loss was held foreseeable because the defendant was "a company dealing in implements of manufacture"<sup>125</sup>.

Another factor that has been taken into consideration by the courts is the relationship between the parties, as well as the parties' knowledge of each other's activities. In the so-called "*Cheese case*",<sup>126</sup> decided under ULIS, the plaintiff was a German company that imported cheese from the defendant, a Dutch cheese exporter. The plaintiff sold cheese to other customers, including wholesalers. Three percent of the cheese delivered by the defendant was defective. This caused the plaintiff to lose customers, four of whom were bulk buyers. The plaintiff also had to pay damages to its customers to compensate for the defective cheese, and because of deteriorated business relations with another customer, the plaintiff lost a group delivery arrangement.

The plaintiff claimed damages for lost profits, the damages that it had to pay to customers, as well as the value of the lost delivery arrangement. The *Bundesgerichtshof*, applying Article 82 ULIS, found that all these losses were foreseeable based on previous dealings between the parties and the defendant's knowledge of the plaintiff's activities and of the relevant market:

"[The] seller knew at the time of contract formation that the buyer was a middleman who would resell goods... [and] both the seller and buyer knew that the cheese market in Germany was saturated with Dutch imports so that the threat existed that purchasers such

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<sup>124</sup> Case No 10 Ob 518/95 (6 February 1996) Austrian Supreme Court <<http://cisgw3.law.pace.edu/cases/960206a3.html>> (accessed 18-04-2016).

<sup>125</sup> Case 00 Civ. 5189 (RCC) (12 August 2006) U.S District Court, Southern District of New York <<http://cisgw3.law.pace.edu/cases/060823u1.html>> (accessed 25-03-2016).

<sup>126</sup> Case VIII ZR 210/78 (24 October 1979) 1979 Bundesgerichtshof C/SG <<http://cisgw3.law.pace.edu/cases/791024g1.html>> (accessed 29-01-2016).

as the buyers' customers might change suppliers even for trivially unsatisfactory deliveries."<sup>127</sup>

Another factor used in the determination of foreseeability is trade usage. The CISG makes explicit mention of the fact that trade usage should be considered when determining reasonable foreseeability.<sup>128</sup> It has been held that the foreseeability requirement "can conclusively be met by showing a trade custom".<sup>129</sup> This also appears to be in line with the underlying rationale of the foreseeability theory – trade usage is formative in a party's understandings and expectations when entering into a contract and it can therefore be considered part of what he takes into account when calculating the risks that he is assuming.<sup>130</sup>

In the *Achilleas* case, the losses claimed were far in excess of the normal expected damages in similar cases based on common trade custom in the shipping industry. It was acknowledged that generally accepted trade custom in the shipping market was to restrict liability to losses suffered for the overrun period and not for the entire duration of a following fixture, as was claimed.<sup>131</sup> The House of Lords, instead of incorporating the well-established trade custom into their analysis of reasonable foreseeability, turned to the lack of agreement between the parties about liability for damages to deny the claim. It seems that there was a simpler solution to the issue facing the court in *Achilleas*. If trade usage could be a factor that determines the extent of knowledge imputed to the defendant, there is no need for a reconceptualisation of foreseeability or for a new test.

A final factor that is taken into account in determining foreseeability is the protective purpose of the contractual provision – or the scope of the contract. This corresponds to the *Schutzzwecklehre* as discussed earlier.<sup>132</sup> This approach allows a court to take

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<sup>127</sup> EC Schneider "Case VIII ZR 210/78 (24 October 1929) Digest" (1979) CISG <<http://cisgw3.law.pace.edu/cases/791024g1.html>> (accessed 29-01-2016).

<sup>128</sup> 8 CISG.

<sup>129</sup> EC Schneider "Case VIII ZR 210/78 (24 October 1929) Digest" (1979) CISG <<http://cisgw3.law.pace.edu/cases/791024g1.html>> (accessed 29-01-2016).

<sup>130</sup> Saidov *Damages in International Sales* 111.

<sup>131</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] 1 A.C. 61 66.

<sup>132</sup> Ch 4 (4 3).

into account the purpose of a contract – bearing in mind not only its content but also the circumstances surrounding its conclusion.<sup>133</sup>

This factor was taken into account in the “*Stones case*”.<sup>134</sup> The buyer, a German company, was commissioned to do construction work in Hamburg. For this purpose, it entered into a contract of sale with an Italian company for the provision of natural stones. The seller’s “sluggish and sporadic” deliveries resulted in the buyer being liable for an exceptionally harsh penalty fee toward one of its subcontractors. The court held that the seller was not liable for the penalty fee. It was held to have been unforeseeable by the seller, as “the risk that has materialised... does not conform to the risk of damages assumed by [the] [s]eller.”<sup>135</sup> The scope and purpose of the contract was not to indemnify a buyer against the particular loss in question.

As seen here and previously,<sup>136</sup> there are cases where the consideration of a contract’s purpose provides a fair and appropriate limit on liability for contractual damages. Where a contract has no clearly defined purpose, the *Schutzzweck* approach will not have much value, however.<sup>137</sup> It therefore makes sense to incorporate it as a factor to be considered depending on the circumstances of each case and the particular contract in question. This is what the foreseeability approach under the model instruments has done.

### 6 3 3 3 Effect on imputed knowledge

As we have seen previously,<sup>138</sup> the foreseeability test under the model instruments takes as its point of departure, similar to the traditional foreseeability tests in English and South African law, the knowledge of the defendant. As a result of the flexible approach to foreseeability, however, the approach of the model instruments displays

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<sup>133</sup> H Beale, A Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Texts on Contract Law* 2 ed (2010) 1014.

<sup>134</sup> Case 419 O 48/01 (21 December 2001) District Court Hamburg <<http://cisgw3.law.pace.edu/cases/011221g1.html>> (accessed 17-05-2016).

<sup>135</sup> Case 419 O 48/01 (21 December 2001) District Court Hamburg <<http://cisgw3.law.pace.edu/cases/011221g1.html>> (accessed 17-05-2016).

<sup>136</sup> Ch 4 (4 3).

<sup>137</sup> HLA Hart & T Honoré *Causation in the Law* 2 ed (1985) 477-478.

<sup>138</sup> Ch 6 (6 3 2 1).

a more nuanced treatment of the knowledge that is imputed unto the defendant. In the South African and English approach, a defendant is only expected to have known about the natural or normal course of events. No other knowledge is imputed to him.

By contrast, the model instruments impute knowledge to the defendant based on his actual knowledge. In other words, actual knowledge could influence the extent of knowledge that a defendant can be taken to have had. The CISG not only refers to what a defendant ought to have foreseen in the light of what he actually knew. It also considers what a defendant *ought to have known*.<sup>139</sup> For example:

“The extent of a buyer’s lost profits and liability to its sub-buyers may be held foreseeable because of the supplier’s *actual* knowledge that the buyer is a trader and the further knowledge *imputed* to the supplier, in the light of his own business experience, of the usual levels of profit margins received from the sale of goods in question. In other words, a piece of actual knowledge often triggers a further presumption about what the seller is then *expected* to know.”<sup>140</sup>

An example of this is provided in Case 48 of 2005 (Ukraine).<sup>141</sup> Here, the arbitration panel found that the seller knew that the goods being sold were purchased by the buyer for purposes of processing and sale of a derivative product. The arbitration panel concluded that, due to this knowledge, the seller *ought to have realised* that stoppage of supply would cause certain losses for the buyer, and accordingly the seller was held liable for those losses.<sup>142</sup>

This seems like a more reasonable way to deal with the issue of foreseeability. In short, it makes the inquiry dependent on the particular facts of each case, without determining a hard-and-fast formula according to which foreseeability can be determined. The key question in each case is simply whether the defendant could reasonably have taken the risk of damages into account when entering into the contract.

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<sup>139</sup> 74 CISG, (emphasis added).

<sup>140</sup> Saidov *Damages in International Sales* 105 (emphasis in the original).

<sup>141</sup> *Ukraine arbitration proceeding* (48/2005) 2005 Tribunal of International Commercial Arbitration at the Ukraine Chamber of Commerce and Trade CISG <<http://cisgw3.law.pace.edu/cases/050000u5.html>> (accessed 04-01-2016)

<sup>142</sup> Saidov *Damages in International Sales* 105.

## 6 4 Conclusion

This chapter has highlighted the foreseeability theory as reflected in the model instruments. While its formulation is largely similar to what we have seen in South Africa and England, it is applied in a more flexible manner. Under the model instruments, foreseeability is determined with reference to a variety of different considerations and not only the defendant's actual knowledge and the abstract idea of a normal course of events. The foreseeability inquiry is shaped by the particular facts and circumstances of a case, in other words. The result seems to be a test that is able to avoid the pitfalls that have been discussed in the preceding chapters.

Over the course of this study, the need for a flexible approach to remoteness in contract has been confirmed for each of the different theories. Despite its flaws, the direct consequences theory is praised because it allows for a judicial discretion and the consideration of policy factors when determining remoteness.<sup>143</sup> In Germany, the adequate cause theory shifted from a strict application of probabilistic analysis to a guideline for the application of common-sense principles and policy factors.<sup>144</sup> It also came to be supplemented with the *Schutzzwecklehre*. This was in recognition of the fact that the particular purpose and context of a contract must be taken into consideration.<sup>145</sup> In English law, we have seen that the foreseeability theory has shifted away from distinctions between general and special damages due to the realisation that different types of damages shade into each other and that liability for damages must be determined on the facts of a particular case.<sup>146</sup> There can be no abstract rule to determine which damages are normal and which are not.

The discussion of each of these theories showed that the strict application of any one test for remoteness failed to yield equitable results in all cases. This is to be expected, given the infinitely variable range of circumstances in which a decision would need to be reached about the limitation of contractual damages.<sup>147</sup> In the context of the foreseeability theory, the conclusion seems to be that

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<sup>143</sup> Ch 3 (3 5).

<sup>144</sup> Hart & Honoré *Causation in the Law* 475.

<sup>145</sup> Ch 4 (4 3).

<sup>146</sup> Ch 5 (5 2 2).

<sup>147</sup> J Gotanda "Article 74" in *UN Convention on Contracts* 991.

“foreseeability should not be taken literally. It is quite amenable to normative characterisation.”<sup>148</sup>

The way forward, therefore, might lie in the development of an approach to foreseeability that allows courts to take account of the particular circumstances of each case. We have seen previously that the foreseeability theory as currently applied in South Africa is especially ill-suited to do that. South African courts determine the recoverability of general damages with reference to the concept of a normal course of events – “damages that flow naturally from the breach in question”<sup>149</sup>. However, over the course of this study, we have seen that what can be considered “normal” or “usual” cannot be determined in the abstract or in a vacuum. The extent to which particular consequences of a breach are normal would depend on the party’s knowledge and expertise, the circumstances surrounding the conclusion of the contract, the scope and purpose of the contract, previous dealings between the parties, trade customs, and any number of other factors. None of these considerations are taken into account when determining whether or not losses are “usual” and therefore recoverable as general damages in South African law. Any losses that cannot be recovered as general damages, will only be recoverable as special damages if that has been agreed by the parties.<sup>150</sup> It would seem that this is not a principled approach suited to the proper allocation of risks of losses arising from breach, where it would be of central importance to determine what parties could have (and should have) taken into account when entering into a contract.

The foreseeability approach under the model instruments has provided some key insights in this regard. They have taken the foreseeability approach from an obscure and abstract formula to an approach which takes into account tangible and concrete considerations.

First, we have seen that what can be foreseen – i.e. what can be considered losses arising in the normal course of events – cannot be defined in abstract terms. Rather, a defendant’s particular position, knowledge, as well as the commercial context of a

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<sup>148</sup> Zeller *Damages* 99.

<sup>149</sup> *Victoria Falls and Transvaal Power Company v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

<sup>150</sup> *Shatz Investments (Pty) Ltd v Kalovyrynas* 1976 2 SA 545 (A) 552B.

contract will inform what is considered general and normal. This has also been suggested by South African authors who are critical of our current approach.<sup>151</sup>

Secondly, if we accept that foreseeability should be determined by taking into account a particular set of facts, then it follows that there are many considerations playing into such an analysis. The question is simply whether the defendant reasonably could have been able to consider these particular losses upon contract conclusion. In answering this question, it is clear that not only knowledge about the possibility of harm contributes to a conclusion. The trade usage and customs of the industry in which a defendant operates, the relationship he has with the other party, the knowledge and experience he has of a particular transaction, the risk allocation within the contract, as well as the purpose of the contract all contribute to a fair decision as to what a defendant can be expected to have foreseen.

Of course not all of these factors will always contribute to a conclusion as to foreseeability. There might also be other important factors to be taken into account, such as the fault of the defendant, or the proportionality between contract price and harm caused. Nevertheless, the underlying principle is that a closed list of rigorously defined determinants of foreseeability leaves the test sterile. The way forward might be to apply the foreseeability principle flexibly depending on the facts of a particular case. The concluding chapter of this study will explore how such an approach could operate in the context of the South African law of contract.

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<sup>151</sup> SWJ van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract – General Principles* 4 ed (2012) 172.



## CHAPTER 7: CONCLUSION

### 7 1 Introduction

This study has explored the origins, development, and merits of different approaches to remoteness of contractual damages. In the context of the rules on contractual damages, it has been noted that:

“We are still all too willing to embrace the conceit that it is possible to manipulate legal concepts without the orientation which comes from the simple inquiry: toward what end is this activity directed? Nietzsche’s observation, that the most common stupidity consists in forgetting what one is trying to do, retains a discomforting relevance to legal science. In no field is this more true than in that of damages.”<sup>1</sup>

The discussion in the preceding chapters suggests that this observation is especially appropriate in the context of the rules of remoteness. It has been indicated in Chapter 2 that much of the criticism of the current South African approach is related to the lack of certainty about the fundamental purpose and nature of the remoteness inquiry.<sup>2</sup> This was also seen in the context of the other theories of remoteness. In the light of this uncertainty, various theories of remoteness were discussed with the purpose of discovering the underlying rationale of the remoteness inquiry. Against the background of that rationale, the study aims to identify the most appropriate approach in the context of South African contract law. This final chapter seeks to highlight the most important conclusions in this regard.

The following section will illustrate that, across different theories of remoteness, the determination of what the parties could have considered when contracting has been recognised as a key underlying principle when determining remoteness of contractual damages. As will be shown, the question as to what parties could reasonably have considered when contracting can best be answered with reference to the foreseeability theory. This theory is also in line with the principle of economic efficiency, and can be supported on constitutional grounds.

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<sup>1</sup> LL Fuller & WR Purdue “The Reliance Interest in Contract Damages: 1” (1936-1937) 46 *Yale L J* 52 52.

<sup>2</sup> Ch 2 (2 5).

This will be followed by a discussion of the conclusions that can be drawn from the findings regarding the application of the foreseeability theory. A few key observations are made about the way in which the foreseeability theory could be approached to avoid some of the identified problems with its application. The ultimate conclusion is that the foreseeability theory should be applied in a flexible manner with reference to the particular facts of each case.

## **7 2 The most appropriate theory for determining remoteness: The foreseeability theory**

The preceding chapters explored several strengths and weaknesses of theories on remoteness. From these findings it can be concluded that the foreseeability theory is the most appropriate approach in the South African legal context for at least three reasons. First, it is in line with the underlying rationale for the limitation of contractual damages as identified by this study. Secondly, it provides for an economically efficient limit on the extent of liability for contractual damages. Finally, the foreseeability theory is aligned to the constitutional values that inform the development of the South African law of contract – in particular the value of human dignity. These reasons will now be considered in more detail.

### **7 2 1 The underlying rationale for the limitation of contractual damages**

It is trite that liability for damages cannot extend indefinitely. After factual causation has been established between breach of contract and losses suffered, the extent of those losses might be in excess of what would seem reasonable to impose on a defendant. It seems intuitively unfair, or in the words of Justinian “not in accordance with nature”,<sup>3</sup> to impose limitless liability on a defendant for all factually-caused damage. It is therefore understandable that already early in the civilian tradition legal principles governing the limits of contractual liability have been part of the law of contract.

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<sup>3</sup> C 7.47.1 as translated in SP Scott *The Civil Law – Translated from the Original Latin* 5-6 (2001) 67.

As we have seen,<sup>4</sup> Roman law provided no general rule or single underlying principle to govern remoteness in contract,<sup>5</sup> but rather developed different rules for particular contexts, such as the non-delivery of a thing causing harm,<sup>6</sup> delivery of a defective *merx*,<sup>7</sup> or lease of a defective *res*.<sup>8</sup> Reasons advanced for these limitations were often diverse. Some limitations were explained with reference to the closeness of the connection between the harm suffered and the breach committed,<sup>9</sup> and others with reference to the relative ease with which a defendant could have known about the possible consequences of his breach.<sup>10</sup>

These limitations were later explained by Molinaeus with reference to one core underlying principle: a defendant should only be liable for damages which he could have foreseen (and therefore could have taken into account) at contract conclusion.<sup>11</sup> This principle was further developed by Pothier:

“[T]he debtor is only liable for the damages and interests which might have been contemplated at the time of the contract, for to such alone the debtor can be considered as having intended to submit.”<sup>12</sup>

Pothier’s further elaboration of foreseeability as a limit on damages incorporated a distinction between intrinsic and extrinsic damages, each with its own implication for what a defendant could be considered to have contemplated.<sup>13</sup> This has had a pronounced impact on the way in which foreseeability has been approached in both English and South African law.<sup>14</sup> In the case of the latter, Pothier’s distinction between

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<sup>4</sup> Ch 2 (2 2).

<sup>5</sup> HJ Erasmus “n Regshistoriese Beskouing van Codex 7.47” (1968) 31 *THRHR* 213 217.

<sup>6</sup> D 19.1.21.3 as translated in A Watson *The Digest of Justinian* 2 (1985) 94.

<sup>7</sup> DJ Joubert “Lawyers, Arguments, Principles and Authority” in C Visser (ed) *Essays in Honour of Ellison Kahn* (1989) 173 174, with reference to the writings of Pomponius, Ulpian and Labeo on the issue.

<sup>8</sup> D 19.2.91.1 as translated in Watson *The Digest* 2 105.

<sup>9</sup> D 19.1.21.3 as translated in A Watson *The Digest* 2 94.

<sup>10</sup> D 19.2.91.1 as translated in Watson *The Digest* 2 105, discussed in DJ Joubert “Lawyers, Arguments, Principles and Authority” in *Essays in Honour of Ellison Kahn* 174.

<sup>11</sup> Erasmus 1975 *THRHR* 117.

<sup>12</sup> WD Evans *RJ Pothier: Treatise on the Law of Obligations or Contracts – Translated from French* (1853) para 160.

<sup>13</sup> Paras 161-163.

<sup>14</sup> JC De Wet & AH van Wyk *Die Suid-Afrikaanse Kontraktereg en Handelsreg* 5 ed (1992) 227.

intrinsic and extrinsic damages is sometimes equated with the distinction between general and special damages.<sup>15</sup>

Later on in this chapter<sup>16</sup> these issues relating to the application and interpretation of the foreseeability theory will be considered in more detail, but for present purposes the focus will be on the core principle underlying this theory, namely that liability for contractual damages should be limited with reference to what the parties could have taken into account when entering into the contract.<sup>17</sup> In other words,

“[t]he underlying idea of the rule is that the parties, at the conclusion of the contract, should be able to calculate the risks and potential liability they assume by their agreement.”<sup>18</sup>

A recognition of the importance of this consideration seems to have formed part of the evaluation of the direct consequences theory and the development of the adequate cause theory.

The direct consequences theory was explored in Chapter 3. In terms of this theory, a defendant will be liable for all direct consequences of the breach.<sup>19</sup> The directness of a consequence is determined with reference to the absence of a *novus actus* or *nova causa* in the sequence of events leading from the breach to the harm suffered by the plaintiff.<sup>20</sup> In determining whether a particular factor did indeed constitute an intervening cause, courts take into consideration a wide range of policy factors and fairness considerations.<sup>21</sup> These include the nature of the interests that have been harmed,<sup>22</sup> as well as the foreseeability of harm.<sup>23</sup>

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<sup>15</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687H; *Whitfield v Phillips* 1957 3 SA 318 (A) 329D.

<sup>16</sup> Ch 7 (7 3 1).

<sup>17</sup> R Zimmermann “Limitation of Liability for Damages in European Contract Law” (2014) 18 *Edin. L. R.* 193 206.

<sup>18</sup> P Schlechtriem *Uniform Sales Law – The UN Convention on Contracts for the International Sale of Goods* (1986) 96.

<sup>19</sup> *In re an arbitration between Polemis and another and Furness, Withy and Co. Ltd* [1921] 3 K.B. 560 574.

<sup>20</sup> *Weld-Blundell v Stephens* [1920] A.C. 956 983-934.

<sup>21</sup> *Liesbosch Dredger v SS Edison* [1933] A.C. 449 460.

<sup>22</sup> RG McKerron *The Law of Delict* 6 ed (1965) 127.

<sup>23</sup> JC De Wet “Opmerkings oor die Vraagstuk van Veroorsaking”(1941) 5 *THRHR* 126 138.

In the application of the direct consequences theory to the law of contract, it was recognised that a test for remoteness has to take account of the fact that parties to a contract need to reasonably know what risks and obligations they are undertaking when entering into a contract.<sup>24</sup> The direct consequences theory was ultimately rejected because, amongst other considerations, it was considered unfair to hold someone liable for consequences that he could not reasonably have foreseen.<sup>25</sup>

We also see an acknowledgement of this core principle in the adequate cause theory.<sup>26</sup> Broadly speaking, this theory applies community standards of justice and fairness to determine whether there is a sufficiently strong causal nexus between a breach of contract and the harm suffered as a consequence of that breach. The question is whether the breach of contract would have the general tendency, based on human experience and knowledge, to increase the objective probability of the harm in question to occur.<sup>27</sup> If the answer is in the affirmative, the breach is considered to have been an adequate cause of the harm in question, and liability for such damages will be imposed.<sup>28</sup>

The adequate cause theory was initially formulated as a description of causal relationships rather than as a justification for the limitation of liability.<sup>29</sup> However, we have seen how courts have moved away from a strict probabilistic analysis of cause and consequence, towards a focus on common-sense policy factors. As the *Bundesgerichtshof* has stated:

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<sup>24</sup> AL Goodhart "The Imaginary Necktie and the Rule in *In Re Polemis*" (1952) 68 *LQR* 514 517-519; HJ Erasmus & JJ Gauntlett "Damages" in WA Joubert, JA Ferris, LTC Harms (eds) *LAWSA* 7 2 ed (1995) paras 33-34; SL Porter "The Measure of Damages in Contract and Tort" (1933-1935) 5 *Cambridge L.J.* 185; RG McKerron "Foreseeability is All: A Critical Note on *The Wagon Mound*" (1961) 78 *SALJ* 282 288; McKerron *The Law of Delict* 169.

<sup>25</sup> *Overseas Tankship (U.K.) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound)* [1961] 1 All E.R. 388 413.

<sup>26</sup> Ch 4.

<sup>27</sup> BS Markesinis & H Unberath *The German Law of Torts – A Comparative Treatise* 4 ed (2002) 106-107.

<sup>28</sup> AT von Mehren & JR Gordley *An Introduction to the Comparative Study of Law – The Civil Law System* (1977) 1115.

<sup>29</sup> HLA Hart & T Honoré *Causation in the Law* 2 ed (1985) 432.

“[O]nly if courts remain conscious of the fact that the question is not really one of causation but of fixing the limits within which the author of a condition can fairly be made liable for its consequences... can they avoid schematising the adequate cause formula and guarantee correct results.”<sup>30</sup>

The adequate cause theory came to be understood, therefore, as “a corrective device which can limit the purely logical consequences of causation in the interest of equity”.<sup>31</sup> Courts have also held that the adequate cause test merely aims to exclude liability for harm that falls beyond the expected course of things.<sup>32</sup>

As discussed in chapter 4, the adequate cause theory came to be supplemented with the *Schutzzwecklehre* or “protective purpose of the norm” approach.<sup>33</sup> This approach is premised on the idea that liability for damages

“depends on the *sense* and *scope* of the contract, [and] what *interests* the creditor should have been warranted by the promise.”<sup>34</sup>

When deciding on the limits of liability, courts therefore consider the appropriate scope (*Schutzbereich*) of a breached contractual term, determined with reference to the contract’s purpose (*Normzweck*).<sup>35</sup>

The development of the adequate cause test and the subsequent adoption of the *Schutzzweck* approach both indicate an awareness of the idea that the limits of contractual liability should be determined with reference to what a defendant could have considered when entering into a contract.

Over the course of this study, we have therefore seen how different theories converge around this central idea. Despite differences between the respective approaches, they all acknowledge the importance of considering what parties could have bargained for

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<sup>30</sup> BGHZ 3 (1951), 261, 267 as translated in Hart & Honoré *Causation in the Law* 475.

<sup>31</sup> BGHZ 30, 154, 157; BGHZ 3, 261, 267 as translated in BS Markesinis *A Comparative Introduction to the German Law of Tort* 3 ed (1994) 101.

<sup>32</sup> BGH NJW 2001, 514 515 as cited in T Wagner “Limitations of Damages for Breach of Contract in German and Scots Law” (2014) 10 *Hanse LR* 73 83.

<sup>33</sup> H Beale, A Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Text on Contract Law* 2 ed (2010) 1011.

<sup>34</sup> E Rabel “A Draft of an International Law of Sales” (1938) 5 *U Chi L Rev* 543 555, (emphasis in original).

<sup>35</sup> Hart & Honoré *Causation in the Law* 476.

at contract conclusion. This is the premise of the foreseeability theory. The direct consequences theory was rejected for its inability to take this into account, and the adequate cause theory has developed and adopted the *Schutzzwecklehre* to be better able to take it into account.

This rationale for the limitation of contractual damages has also been acknowledged by South African courts, especially in early case law. An example is provided in *Stent v Gibson Brothers*,<sup>36</sup> where the court held that:

“[t]he question seems to come to this: was the [damage] a matter of such ascertainable value [at the time of contract conclusion], as to have been capable of contemplation by both parties?”<sup>37</sup>

In the light of the preceding discussion, it therefore appears that the preferable point of departure for any theory of remoteness in contract is to identify what parties could reasonably have taken into account at the time of conclusion of the contract.

In this regard it seems that foreseeability is the best approach to assist in this determination.<sup>38</sup> To determine what parties could have considered when contracting, the foreseeability approach asks simply what a defendant did, or could, foresee. This question can be answered with reference to a wide range of factors, as is suggested in this study. Such a flexible approach takes the entire contractual context and the parties' subjective positions into account.

By contrast, the other approaches have a more limited focus. The adequate cause theory determines what parties could have considered with reference to the notion of a normal or expected course of events, and the *Schutzzwecklehre* examines the purpose of the contract. The direct consequences theory seeks to determine the strength of the causal relationship between breach and consequence. Although these considerations can in some cases indicate what parties could have considered, simply

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<sup>36</sup> 1888-1889 5 HCG 148.

<sup>37</sup> 151.

<sup>38</sup> Hart & Honoré *Causation in the Law* 230; EA Farnsworth “Legal Remedies for Breach of Contract” (1970) 70 *Columbia L Rev* 1145 1208; D Saidov *The Law of Damages in International Sales – the CISG and Other International Instruments* (2008) 102.

asking which consequences were foreseeable allows courts to determine this with reference to these, and other factors.

## 7 2 2 Economic efficiency

It is widely accepted that rules on remoteness of contractual damages are necessary to prevent economic inefficiency.<sup>39</sup> Without clearly defined rules governing the extent to which parties will be liable for the consequences of breach, the costs and risks involved in contracting increases.<sup>40</sup> Parties will not be able to determine the extent of risk for liability that they are assuming in terms of the contract, and will therefore not be able to take efficient precautions to avoid losses caused by breach. They will also not be able to determine an optimal contract price that takes into account the costs of such precautions.<sup>41</sup> Alleviating these inefficiencies will only be possible if parties can contract about all possible contingencies arising from breach – which is not always possible, and if possible, could be expensive.<sup>42</sup>

It is therefore clear that any theory of remoteness must be able to address these inefficiencies effectively. In this regard, it has been argued that the foreseeability theory provides the most efficient solution.<sup>43</sup> This is because the foreseeability theory ensures an economically efficient allocation of the costs and efforts involved in taking precautions against the consequences of breach.

In terms of the foreseeability theory, the risk of all reasonably foreseeable consequences of breach will lie with the defendant (i.e. the party ultimately in breach). Reasonably able to know about these risks, he would be in a position to take optimal precautionary steps against these losses, and include the costs of such steps in the proposed contract price.<sup>44</sup> However, and as a point of departure, the plaintiff will be

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<sup>39</sup> MG Bridge *The Sale of Goods* (1997) 541.

<sup>40</sup> RA Posner *Economic Analysis of Law* 6 ed (2003) 95.

<sup>41</sup> C Pazuic "Remoteness of Damage in Contract and its Functional Equivalents: A Critical Economic Approach" (2016) 5 *UCLJLJ* 87 89.

<sup>42</sup> JH Barton "The Economic Basis of Damages for Breach of Contract" (1972) 1 *J Leg Stud* 227 295; Posner *Economic Analysis of Law* 96.

<sup>43</sup> Barton 1972 *J Leg Stud* 295-296

<sup>44</sup> LA Bebbuchuck & S Shavell "Information and the Scope of Liability for Breach of Contract: The Rule of *Hadley v Baxendale*" (1991) 7 *J L Econ & Org* 284 286.



liable for all consequences of breach that are not foreseeable by the defendant. It is the plaintiff's responsibility, therefore, to limit those losses.<sup>45</sup> This avoids economically inefficient levels of reliance by the plaintiff on the defendant's performance (in other words, it prevents the plaintiff from "over-relying" on the defendant's performance).<sup>46</sup> In cases where the defendant would be better placed to avoid such losses, the plaintiff is incentivised to disclose the risk of unusual losses to the defendant.<sup>47</sup> This disclosure renders these unusual losses reasonably foreseeable to the defendant, and he would therefore be liable also for those losses upon breach. Here too however, the prior disclosure of unusual losses allows the defendant to take increased precautions<sup>48</sup> and to include the increased cost of those precautions in an increased contract price.<sup>49</sup> The foreseeability approach therefore promotes economically efficient contract prices and ensures economically optimal levels of precaution against the consequences of breach, by allocating the risk of future loss to the party best placed to take precautions and to cater for them accordingly.

In the law and economics literature, arguments have been made that the same efficiency gains could possibly also be obtained where no limits are placed on the recovery of contractual damages.<sup>50</sup> Many of these arguments rely on stringent assumptions,<sup>51</sup> and results about the "most" economically efficient approach to remoteness are often inconclusive.<sup>52</sup> Regardless, it must be noted that the economic efficiencies ascribed to the foreseeability theory will not always materialise exactly as

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<sup>45</sup> Posner *Economic Analysis of Law* 122.

<sup>46</sup> 127-128.

<sup>47</sup> J Cartwright "Remoteness of Damage in Contract and Tort: A Reconsideration" (1996) 55 *Cambridge L J* 488 491.

<sup>48</sup> Pazuic 2016 *UCLJLJ* 89.

<sup>49</sup> Barton 1972 *J Leg Stud* 296.

<sup>50</sup> EA Posner "Contract Remedies: Foreseeability, Precaution, Causation and Mitigation" in B Bouckaert & G De Gees (eds) *Encyclopedia of Law and Economics III* (2010) 166; Bebchuck & Shavell 7 *J L Econ & Org* 308-309.

<sup>51</sup> For instance, about the risk aversion of parties to a contract: JM Perloff "Breach of Contract and the Foreseeability Doctrine of *Hadley v. Baxendale*" (1981) 39 *J Leg Stud* 39 62-63; the cost of communicating information: Posner "Contract Remedies" in *Encyclopedia of Law and Economics* 167; and the distribution of parties that over- or undervalue performance: Bebchuck & Shavell 1991 *J L Econ & Org* 288.

<sup>52</sup> Posner "Contract Remedies" in *Encyclopedia of Law and Economics III* 166; Bebchuck & Shavell *J L. Eco. & Org.* 308-309; Perloff *J Leg Stud* 39 62-63.

predicted by theoretical studies. However, in light of the analysis above it is reasonable to conclude that the foreseeability theory provides an economically efficient (albeit at times imperfect), solution.

### 7 2 3 The Constitutional values informing the South African law of contract

The Constitution<sup>53</sup> of South Africa embodies a value system that, ultimately, constitutes the supreme law of the land.<sup>54</sup> The founding values of the Constitution include “human dignity, the achievement of equality and the advancement of human rights and freedoms”.<sup>55</sup> Public policy in South Africa is rooted in these values,<sup>56</sup> and it has been acknowledged by the Constitutional Court that “it is highly desirable and in fact necessary to infuse the law of contract with Constitutional values”.<sup>57</sup> Accordingly, it is accepted that the Constitution obliges South African courts to ensure conformity between fundamental human rights and constitutional values, and the law of contract.<sup>58</sup> This suggests that it is necessary to consider to what extent the foreseeability theory, applied in the manner suggested by this study, would also be able to give expression to these underlying values – in particular, the value of human dignity.

Human dignity is, as is the case with most broad and abstract values, complex and its meaning often elusive.<sup>59</sup> Broadly speaking the value of human dignity is taken to imply a respect for the inherent worth of every human being.<sup>60</sup> It is often explained with reference to the Kantian argument that a human being should be treated as an end in itself, and not a means to an end.<sup>61</sup> Human beings should be respected as

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<sup>53</sup> Constitution of the Republic of South Africa, 1996.

<sup>54</sup> FDJ Brand “The Role of Good Faith, Equity and Fairness in the South African Law of Contract: The Influence of the Common Law and the Constitution” (2009) 126 *SALJ* 71 71.

<sup>55</sup> Section 1(a) Constitution of the Republic of South Africa, 1996.

<sup>56</sup> *Barkhuizen v Napier* 2007 3 SA 323 (CC) para 28.

<sup>57</sup> *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) para 71.

<sup>58</sup> GF Lubbe “Taking Fundamental Rights Seriously: The Bill of Rights and its Implications for the Development of Contract Law” (2004) 121 *SALJ* 395 407.

<sup>59</sup> Lubbe 2004 *SALJ* 421.

<sup>60</sup> O Schachter “Human Dignity as a Normative Concept” (1983) 77 *Am. J. Int’l L.* 848 849.

<sup>61</sup> Lubbe 2004 *SALJ* 421; Schachter 1983 *Am. J. Int’l L.* 849; GP Fletcher “Human Dignity as a Constitutional Value” (1984) 22 *U W Ontario L Rev* 171 171.

autonomous individuals, and not treated as instruments of others' wills.<sup>62</sup> Two dimensions to this value can be identified. One relates to empowerment (individual autonomy and freedom) and the other to restriction (restraint of that freedom to protect others' dignity).<sup>63</sup> In other words, the value of human dignity protects each person's inherent worth by requiring a respect for the autonomous choices and acts of that person. In this regard, it implies empowerment and individual freedom. On the other hand, it also requires that this person's actions do not infringe on the autonomy and inherent worth of other human beings. This dimension of human dignity implies restraint.

The foreseeability theory of remoteness, particularly when applied in the manner suggested in this study, is in line with both these dimensions. On the one hand it honours autonomy and individual freedom, and on the other hand it limits that freedom by requiring a party to consider the interests of the other party to the extent that that is reasonable.

With regards to the former dimension, the foreseeability theory holds a defendant liable for the consequences of his actions. Respect for his autonomy is manifested in the rule that he is only held liable for those consequences that he foresaw. This principle inherently respects his ability to make choices, and honours his autonomy by limiting the consequences of his choices to those for which he freely assumed risk. However, the foreseeability theory does not ask only what a defendant foresaw, but also what he reasonably could have foreseen. This gives effect to the second dimension of human dignity – it constrains the defendant's autonomy by also requiring him to reasonably accommodate the interests of the other party.

The foreseeability theory also gives effect to the value of dignity when considered from the perspective of the plaintiff. It requires a plaintiff to disclose knowledge that he might have about the possibility of unusual losses. If he does not share that information, he would bear the risk for the loss, where the defendant would not have reasonably been able to foresee the damage in question. A plaintiff will only be able to recover unusual losses where he disclosed the possibility or risk of such losses to the defendant,

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<sup>62</sup> Schachter 1983 *Am J Int'l L* 849.

<sup>63</sup> Lubbe 2004 *SALJ* 421.

thereby rendering them reasonably foreseeable to the latter. The result is that the foreseeability approach requires a plaintiff to consider and respect the defendant's position and knowledge when contracting. From the perspective of both the plaintiff and the defendant, therefore, the foreseeability theory requires an acknowledgement of the interests and inherent worth of the other party.

This section has illustrated that any test of remoteness must, ultimately, be focussed on determining what parties could reasonably have taken into account when contracting. It has been argued that the foreseeability theory is best placed to determine this accurately, and that the foreseeability theory is also in line with the principle of economic efficiency and the constitutional value of human dignity.

However, the traditional tests for foreseeability have not always been able to answer the core question – what could parties reasonably have taken into account when contracting – satisfactorily. As a consequence, these traditional tests have also not been able to ensure economic efficiency or give effect to constitutional values. This study has highlighted many aspects of traditional foreseeability tests such as those seen in England and South Africa that do not, in fact, allow courts to answer the core question at the heart of the foreseeability inquiry. The next section explores some of the lessons learnt with regards to application of the foreseeability theory.

### **7 3 Conclusions on the application of the foreseeability theory**

#### **7 3 1 The distinction between different types of damages**

Drawing a distinction between different *types* of damages and formulating rules as to requirements for each type's recovery does not necessarily contribute to the remoteness inquiry. This was seen in particular with reference to the discussion of remoteness in the English law of contract.<sup>64</sup> This is because, in terms of the foreseeability theory, recovery of *all* types of losses is determined with reference to the same underlying principle. Developing separate tests for different types of losses has reduced the focus on this underlying principle, namely that parties must have been reasonably able to know what they were bargaining for upon contract conclusion.

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<sup>64</sup> Ch 5 (5 2 2).

In the works of Pothier we first encountered a distinction between damages that will be generally recoverable and damages that can only be recovered under certain circumstances.<sup>65</sup> Pothier drew a distinction between extrinsic and intrinsic damages. He described intrinsic damages as compensation for losses suffered “in respect to the thing which is the object of the obligation”.<sup>66</sup> A defendant would be presumed to have foreseen such losses, and it would therefore be recoverable. All other losses were considered extrinsic. Extrinsic damages would only have been recoverable if the risk of those losses was expressed in the contract and therefore contemplated by the defendant. Then the defendant

“shall be answerable even for the extrinsic damages... for by the clause in the agreement the risk of this damage was foreseen and expressed, and [the defendant] deemed to have taken it upon [himself].”<sup>67</sup>

The operating principle behind the distinction is in line with the idea that a party should only be liable for what he could have taken into account at the conclusion of the contract. The distinction between intrinsic and extrinsic damages is based on a rule as to what a defendant can reasonably be expected to have taken into account. In Pothier’s work, a defendant can be expected to have taken into account losses suffered in respect of the thing that is the object of the obligation.

As we have seen, it is problematic to formulate a single rule in the abstract that can reliably determine what a party could reasonably have taken into account in all cases. In many cases it might be less, or more, than the losses suffered in respect of the thing that is the object of the obligation. It might also be difficult to know exactly what constitutes “damage suffered in respect of the thing that is the object of the obligation”. The same shortcomings were observed in the context of the distinction between general and special damages.

In the seminal case on the foreseeability theory in English law, *Hadley v Baxendale* (“*Hadley*”),<sup>68</sup> the court drew a distinction between loss arising in the normal course of events (general damage) and that which does not (special damage). According to the

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<sup>65</sup> Ch 2 (2 3 1).

<sup>66</sup> Evans *Pothier: A Treatise on the Law of Obligations* para 161.

<sup>67</sup> Para 162.

<sup>68</sup> [1854] 9 Ex. 341.

court, the defendant is deemed to have foreseen the former, but not the latter.<sup>69</sup> In other words, liability for general damages would be based on imputed knowledge, and liability for special damages on actual knowledge.

The problem with this distinction is that it relies on a notion of a “normal course of events”, which, as we have seen, cannot be satisfactorily defined in the abstract without reference to the circumstances of a particular case. The same criticism is also raised in the context of the South African distinction between general and special damages, which has been described as artificial and theoretically impure.<sup>70</sup> When determining whether or not losses suffered can be recovered as general damages, South African courts only refer to the content of the contract.<sup>71</sup> The concept of a normal course of events, or of the natural consequence of a breach, is therefore determined largely in a vacuum and without reference to the subjective positions and knowledge of parties.

As was seen in the preceding chapter on foreseeability under the model instruments, what would be considered “normal” or “usual” losses to a defendant upon contract conclusion is dependent on the particular circumstances of the case. A defendant’s expertise and knowledge, the commercial context of the contract, the scope and purpose of the contract, previous dealings between the parties – these and many other factors might influence what a defendant can be expected to have known and foreseen when contracting. All of this would influence the knowledge that can reasonably be imputed to the defendant. It seems that the distinction between general and special damages has created an artificial distinction between the tests for subjective (actual) and objective (imputed) knowledge.

As was clarified in *Victoria Laundry (Windsor) LD v Newman Industries LD* (“*Victoria Laundry*”)<sup>72</sup> the tests for subjective and objective knowledge are not analytically

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<sup>69</sup> 354-355.

<sup>70</sup> De Wet & Van Wyk *Die Suid-Afrikanse Kontraktereg en Handelsreg* I 227. *Durban Picture Frame Co (Pty) Ltd v Jeena* 1976 1 SA 329 (D) 335-336 describes the approach as having “limited practical use”.

<sup>71</sup> SWJ Van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Contract - General Principles* 4 ed (2012) 370.

<sup>72</sup> [1949] 2 K.B. 528 540.

distinct. Rather, the one shades into the other as a defendant's liability increases with his knowledge.<sup>73</sup>

It seems that the capacity of a foreseeability test to determine accurately what parties could have foreseen at contract conclusion would benefit from the abandonment of the distinction between types of damages. A more sensible approach is simply to determine, with reference to the particular circumstances of each case, what a party can reasonably be expected to have foreseen. All such knowledge should be imputed to the party. All losses that were not reasonably foreseeable would only be recoverable if actual knowledge on the part of the defendant can be proven. There is no need to have a pre-formulated abstract rule to determine which losses fall under the former (reasonably foreseeable) and which under the latter (not reasonably foreseeable).

### 7 3 2 The intentions of the parties

A further conclusion to be drawn from the study is that it is ineffective, and arguably unfounded, to determine the limits of liability for contractual damages with reference to the parties' intentions and their agreement on the issue. As discussed previously, early English case law interpreted *Hadley* as requiring an express or tacit agreement between the parties that the defendant would be liable for special damages before those losses would be recoverable.<sup>74</sup> This interpretation had been completely rejected in England by the beginning of the twentieth century,<sup>75</sup> since it was accepted that the foreseeability rule operates as a default rule where there has been no agreement between parties, rather than as a mechanism to discover their agreement. It was settled in English contract law, therefore, that there is no need for agreement between the parties for special damages to be recoverable. Rather, it was sufficient to prove that the parties could reasonably have foreseen unusual losses upon contract conclusion.<sup>76</sup>

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<sup>73</sup> E Peel *The Law of Contract* 13 ed (2011) 1057.

<sup>74</sup> *British Columbia and Vancouver's Inland Spar, Lumber and Saw-Mill Co v Nettleship* (1868) LR 3 CP 499; *Horne v Midland Railway* (1873) LR 7 CP 583.

<sup>75</sup> A Kramer "An Agreement-Centred Approach to Remoteness and Contract Damages" in N Cohen & E McKendrick (eds) *Comparative Remedies for Breach of Contract* (2005) 250.

<sup>76</sup> HG Beale *Chitty on Contracts* 1 31 ed (2012) 26-104; AL Corbin *A Comprehensive Treatise on the Workings of Contract Law* 5 (1964) 1014.



Despite the fact that the tacit agreement requirement had fallen into disfavour in English law, it was incorporated into South African law in the decision of *Lazarus Bros v Davies & Kamann* (“*Lazarus Bros*”).<sup>77</sup> The court, relying on MacKeurtan’s discussion of the early English interpretation of the *Hadley* test,<sup>78</sup> held that special damages will only be recoverable when there has been agreement to that effect.<sup>79</sup> This was confirmed by the Appellate Division in *Lavery and Co v Jungheinrich* (“*Lavery*”),<sup>80</sup> and is still a part of our law of remoteness in contract today.

Apart from the reference to *Lazarus Bros*, the court in *Lavery* also relied on the works of Pothier as authority for the imposition of the convention or agreement requirement.<sup>81</sup> It has been argued that this is not a proper interpretation of Pothier.<sup>82</sup> Our courts have also sometimes interpreted Pothier in a way that does not imply a convention requirement:

“It appears from the way in which the doctrine is stated that neither actual foreseeing of the damages in question, nor express or conscious submission to an obligation to pay such damages is required.”<sup>83</sup>

In addition to highlighting the dubious origins of the convention requirement, this study has also considered some of the problems with requiring agreement between the parties before losses can be recovered. This was done in the discussion of the English approach to foreseeability,<sup>84</sup> particularly with reference to the adoption of the so-called “assumption of responsibility test” in *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* (“*Achilleas*”).<sup>85</sup>

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<sup>77</sup> 1922 OPD 88.

<sup>78</sup> HG MacKeurtan *Sale of Goods in South Africa* (1921) 363-364.

<sup>79</sup> *Lazarus Bros v Davies & Kamann* 1922 OPD 88 91.

<sup>80</sup> 1931 AD 156 169.

<sup>81</sup> 175.

<sup>82</sup> GA Mulligan “Damages for Breach: Quantum, Remoteness and Causality IV: Special Damages in South African Law” (1956) 73 *SALJ* 27 38.

<sup>83</sup> *Bower v Sparks, Young and Farmers’ Meat Industries* 1936 NPD 1 13. This interpretation was also raised in *Shatz Investments (Pty) Ltd v Kalovyrnas* 1976 2 SA 545 SA 553D.

<sup>84</sup> Ch 5.

<sup>85</sup> [2009] 1 A.C. 61.



It will be recalled that this case held that “liability for damages [is founded upon] the intention of the parties (objectively ascertained)”.<sup>86</sup> Under this test, foreseeability is therefore no longer the primary limit on contractual damages, but rather a *prima facie* indication of the parties’ intentions regarding the risk allocation under the contract.<sup>87</sup> This view of the assumption of responsibility test has been confirmed by the Queen’s Bench.<sup>88</sup>

Several points of criticism have been raised against this position. Determining remoteness of damages with reference to the parties’ intentions runs contrary to the underlying premise of the inquiry identified in this study. Arguably, the foreseeability approach is fair and efficient because it imposes liability for all losses that could reasonably have been taken into consideration when contracting. In other words, its economic efficiency and fairness arises from the requirement that a defendant has to reasonably take into account the plaintiff’s interests when contracting, and vice versa. Requiring agreement between parties implies the imposition of an additional requirement: that these consequences should actually have been considered by the parties and, furthermore, that the parties should have reached an agreement on their recoverability. The result is that losses which a defendant, had he been reasonable, could have considered when contracting, will still be carried by the plaintiff unless parties had reached agreement on the issue. This result inhibits the fairness, and the economic efficiency, of the foreseeability approach as identified above.

Scholars have also pointed out that there will not always be reliable methods to discern parties’ intentions with regards to the consequences for breach of contract.<sup>89</sup> Where a clear agreement about liability for such consequences can be discerned, that part of the contract will of course be enforced. The issue of remoteness, however, arises precisely where there has been no clear allocation of risk for consequences for breach. The remoteness inquiry as envisioned in the foreseeability approach functions as a

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<sup>86</sup> *Transfield Shipping Inc v Mercator Shipping Inc, the Achilleas* [2009] 1 A.C. 61 68, (parenthesis in the original).

<sup>87</sup> A Kramer *The Law of Contract Damages* (2014) 290.

<sup>88</sup> *Sylvia Shipping Co Ltd v Progress Bulk Carriers Ltd* [2010] C.L.C. 470. Most recently, this view was confirmed in *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146 para 74.

<sup>89</sup> D Winterton *Money Awards in Contract Law* (2015) 243.

mechanism to distribute *unallocated* risks,<sup>90</sup> in other words. This has also been acknowledged by South African courts:

“In the absence of express provision a rule is needed to regulate the extent of liability which might be incurred by a seller, or carrier, who fails to fulfil his obligations under a contract, and the accepted rule regulates such liability by reference to the circumstances in relation to which both parties knew they were contracting. Under this rule, a seller is by reason of knowledge imparted to him by a purchaser prior to in and in connection with a sale deemed to have undertaken certain obligations which *may not actually have been present to the mind of either party at the time when the transaction was entered into.*”<sup>91</sup>

As we have seen earlier, and as will be discussed below,<sup>92</sup> the traditional application of the foreseeability test has been unable to provide fair results in all cases. This is arguably because of its lack of flexibility, and the fact that it does not take into account the wide range of factors that could contribute to the parties’ contemplation when concluding a contract. There are factors in addition to the objective notion of a “normal course of events” and parties’ particular knowledge of special circumstances surrounding the breach that should be taken into account. The rigid manner in which the foreseeability test has been applied is indeed problematic, and was arguably the reason for the adoption of the assumption of responsibility test in England.

However, imposing a test aimed primarily at discovering parties’ intentions (where these are often absent) seems like an inappropriate solution to an overly restrictive foreseeability test. It is misplaced to introduce the fiction of an underlying risk allocation agreed upon by the parties where such an agreement might be (a) non-existent or (b) not always accurately discernable.

As Farnsworth states, “such a patent fiction is... a poor device to use to gain flexibility”.<sup>93</sup> We saw in Chapter 6, and it will be argued in further detail below, that a better solution would be a more flexible approach to foreseeability. Such an approach could, and should, take the underlying risk allocation of a contract into account – but

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<sup>90</sup> 173.

<sup>91</sup> *Bower v Sparks, Young and Farmers’ Meat Industries, Ltd* 1936 NPD 1 16. Own emphasis.

<sup>92</sup> Ch 7 (7 3 6).

<sup>93</sup> Farnsworth 1970 *Columbia L Rev* 1209.

not to the exclusion of other important considerations and certainly not in cases where there clearly was no such allocation.

### 7 3 3 The distinction between the nature and the extent of harm

Another conclusion is that no rigid distinction can be drawn between the *nature* and the *extent* of harm suffered as a consequence of breach of contract. English law requires only the nature of a particular loss to have been foreseeable, and not its extent.<sup>94</sup> This has led to cases where the traditional foreseeability test as applied in English law would lead to inequitable results. This was discussed specifically with reference to the *Achilleas* decision. There, the extent of the loss claimed was far in excess of what could reasonably have been foreseen by the defendant. In such cases, excluding the extent of the loss from the foreseeability inquiry would lead to the imposition of liability for losses that could not reasonably have been taken into account at contract conclusion. This seems contrary to the rationale underlying the foreseeability inquiry.

In South African law there is no clear statement as to whether the extent of loss or only its nature has to be foreseeable. Upon turning to the model instruments discussed in Chapter 6, we saw that the PICC state that:

“Foreseeability relates to the nature or type of harm but not to its extent unless the extent is such as to transform the harm into one of a different kind.”<sup>95</sup>

This suggests that where the extent of a loss is significantly more than what could have been foreseen, a loss different to the one which was foreseeable has materialised.<sup>96</sup> It seems obvious that the foreseeability requirement cannot expect foreseeability of an exact amount of damages – this is arguably why the extent of a loss has been excluded from the traditional English foreseeability test. However, to

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<sup>94</sup> Peel *Law of Contract* 1056.

<sup>95</sup> UNIDROIT “Official Comments on the UPICC” (2010) *UNILEX* <<http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13637>> (accessed 15-01-2016).

<sup>96</sup> J Gotanda “Article 74” in S Kröll, L Mistelis & PP Viscasillas (eds) *UN Convention on the International Sale of Goods (CISG)* (2011) 745 766.

focus only on the nature of a loss when determining its foreseeability seems illogical if the purpose of the foreseeability enquiry is taken into account.<sup>97</sup>

If we simply ask what a defendant could have reasonably taken into account when bargaining for a contract, that question considers not only the nature but also the extent of possible losses that could be suffered as a consequence of breach. As the PICC imply, this is because the nature of a loss is inextricably linked to its extent; for this reason, it is suggested that the foreseeability inquiry should take this into account.

#### 7 3 4 Foreseeability from the perspective of the defendant alone

English and South African law determine the contemplation of losses from the perspective of both parties to a contract. But an investigation of the foreseeability approach adopted in the model instruments in particular has revealed that it might not be necessary to base a test for foreseeability on the contemplation of both parties.<sup>98</sup>

This logic is based on the notion that, if the loss was foreseeable to the plaintiff, he would be able to inform the defendant of the risk of such loss. If the plaintiff did inform the defendant, the loss would also be foreseeable to the defendant and therefore recoverable. If the plaintiff did not do so, the defendant would be protected. Ultimately, therefore, the enquiry need only focus on whether losses were foreseeable by the defendant.<sup>99</sup> While the results may not be different if reasonable foreseeability is determined from both parties' perspectives, formulating the foreseeability test to focus only on reasonable foresight by the defendant simplifies its application.

#### 7 3 5 The level of probability with which harm has to be foreseeable

Across different jurisdictions and theories of remoteness, we have seen how courts have grappled with the issue of defining the correct level of likelihood with which loss or harm caused by breach of contract ought to have been foreseeable. This study

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<sup>97</sup> See Ch 6 (6 3 2 2).

<sup>98</sup> Ch 6 (6 3 2 1)

<sup>99</sup> E McKendrick "Article 7.4.4" in S Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2 ed (2015) 993. See also Corbin *Contracts* 1010, as cited in AG Murphey "Consequential Damages in Contracts for the International Sale of Goods and the Legacy of *Hadley*" (1989) 23 *Geo Wash J Int'l L & Econ* 415 435.

suggests that it is convoluted and often unhelpful to try to hinge a test for foreseeability on a strictly delineated level of probability with which harm ought to have been foreseeable. In South Africa, early case law stated that harm had to be foreseeable as a *likely* consequence of breach.<sup>100</sup> This was later changed to the arguably stricter requirement that harm should be foreseeable as a *probable* consequence of breach.<sup>101</sup>

In *Thoroughbred Breeders' Association v Price Waterhouse* ("*Thoroughbred Breeders' Association*")<sup>102</sup> Nienaber JA stated that the meaning of the term "probable" does not necessarily imply that harm needs to be more likely to occur than not,<sup>103</sup> but merely that there needs to be a "realistic possibility of harm occurring" for those losses to be recoverable.<sup>104</sup>

In English law there has also been debate around the degree of probability with which harm must be foreseeable. In *Czarnikow v Koufos, The Heron II* ("*The Heron II*"),<sup>105</sup> Lord Reid attacked the blanket use of the term "reasonable foreseeability" as unclear and confusing.<sup>106</sup> In his decision, he formulated the required level of probability as "a serious possibility",<sup>107</sup> "a real danger",<sup>108</sup> "very substantial",<sup>109</sup> "not unlikely"<sup>110</sup> or "easily foreseeable".<sup>111</sup> These terms have not made the inquiry easier or necessarily more precise.

Similar uncertainty arose in the context of the adequate cause theory where scholars disagreed about the level of probability to be attached to a possible consequence

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<sup>100</sup> *Victoria Falls & Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1 22.

<sup>101</sup> *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA (A) 687D; *Lavery and Co Ltd v Jungheinrich* 1931 AD 156 169.

<sup>102</sup> 2001 4 SA 551 (SCA).

<sup>103</sup> 580G.

<sup>104</sup> 581G.

<sup>105</sup> [1969] 1 A.C. 350, see Ch 5 (5 2 2).

<sup>106</sup> 384.

<sup>107</sup> 414-415.

<sup>108</sup> 425.

<sup>109</sup> 388.

<sup>110</sup> 383.

<sup>111</sup> 383.

before its cause can be considered adequate.<sup>112</sup> As we have seen in the discussion of the adequate cause theory, any answer to this question can be manipulated. Moreover, the emphasis on specific levels of probabilities loses sight of the normative nature of the remoteness inquiry. It may be noted that, where remoteness is to be decided on the facts of each case, any delineated level of foreseeability will have to be flexible enough to take the facts of a particular case into account.

### 7 3 6 Flexible application of the foreseeability theory

#### 7 3 6 1 *Rationale for a flexible approach to foreseeability*

A final, broad, conclusion that can be drawn from the research is that the remoteness inquiry is inevitably imprecise. Therefore, the foreseeability theory can only lead to satisfactory results when it is approached and applied in a flexible manner that takes into account the facts and circumstances of a particular case. What can be considered usual and normal in a particular course of events, and what the actual knowledge of a defendant was, as well as what that implies for what he could have taken into account, cannot in all cases be determined with reference to a strictly defined set of determinants, or an abstract rule.<sup>113</sup>

In English law, one of the points of criticism often raised against the traditional application of the foreseeability theory is that the test is imprecise and vague – arguably because it tries to encapsulate the remoteness inquiry into a single consideration. An example of this imprecision is the use of the phrase “damage which occurred in the usual course of things”.<sup>114</sup> The test does not indicate to what extent a court may take into account the commercial context within which the contract was concluded when determining whether or not a specific course of events can be regarded as usual.<sup>115</sup>

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<sup>112</sup> Ch 4 (4 2 2), Hart & Honoré *Causation in the Law* 485.

<sup>113</sup> M Harris “Fairness and Remoteness of Damage in Contract Law: A Lexical Ordering Approach” (2012) 28 *JCL* 122 122.

<sup>114</sup> *Hadley v Baxendale* [1854] 9 Ex 341 354, as quoted in *Bower v Sparks, Young and Farmers' Meat Industries, Ltd* 1936 NPd 1 14; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 687F; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 579E.

<sup>115</sup> 125.

The result is therefore that the traditional foreseeability test is restrictive due to its narrow focus on only the knowledge of parties and the likelihood of harm occurring. The test as it has been formulated and applied in both English and South African law does not take into account other, arguably important, factors. For example, the test does not take into account the proportionality between damage suffered and the breach committed, the nature of the particular contract in question, or public policy considerations.<sup>116</sup> This criticism of the restricted manner in which the test has developed is summarised by Lord Hoffmann:

“*Hadley v Baxendale* is a very good example of a tendency which is endemic in a system of precedent, namely, for judges to take the ground upon which a particular case was decided as the sole criterion upon which different cases should be decided. That leads to an impoverishment of reasoning in subsequent authorities.”<sup>117</sup>

This has been recognised by courts and authors alike. Some authors argue that the reasonable foreseeability test is in fact merely a flexible policy tool, or a set of tests, that can be used by judges to secure just outcomes. For example, Fuller and Purdue argue that the traditional foreseeability test has developed to be less of a definite test in itself; rather, it represents an umbrella term for a developing set of tests.<sup>118</sup>

The second source of criticism is therefore that the restrictive terminology within which remoteness inquiries have been conducted under the foreseeability theory has resulted in a test whose formulation and terminology do not accurately reflect its application. This is problematic, because:

“[T]he practice of disguising substantive principles in another form should be avoided where possible. This kind of camouflage is a shortcoming, not a strength, of the rule as stated in *Hadley* and related cases. It militates against transparency in decision-making, and undermines certainty by not exposing the real reasons underpinning conclusions in the case law.”<sup>119</sup>

This suggests that the foreseeability test has to be applied in a manner which takes cognisance of the wide variety of factors that might render a particular outcome reasonably foreseeable in a particular case. Furthermore, it should be formulated in a

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<sup>116</sup> 127.

<sup>117</sup> L Hoffman “*The Achilles: Custom and Practice or Foreseeability?*” (2010) 14 *Edin. L.Rev.* 47 53.

<sup>118</sup> Fuller & Purdue 1936-1937 *Yale L.J.* 85.

<sup>119</sup> Harris 2012 *JCL* 130.

way that allows courts to describe and acknowledge their consideration of these factors. Arguably, the foreseeability test as applied under the model instruments addresses both these aspects more satisfactorily than has been the case in the application of the traditional foreseeability tests in English and South African law. The model instruments determine foreseeability with reference to a variety of different factors depending on the facts of a case. Furthermore, courts seem to acknowledge the flexible and discretionary nature of the remoteness inquiry. The official comments to Article 7.4.4 PICC state:

“Foreseeability is a flexible concept which leaves a wide measure of discretion to the judge.”<sup>120</sup>

Under the model instruments, the foreseeability test is therefore applied with reference to a wide range of factors,<sup>121</sup> including the scope and purpose of the contract in question,<sup>122</sup> the allocation of risk in the contract,<sup>123</sup> previous dealings between the parties,<sup>124</sup> established practices between the parties,<sup>125</sup> and common trade usage.<sup>126</sup>

It appears as if South African courts may be prepared to adopt a more flexible approach to the remoteness inquiry in the future. They have acknowledged the limitations of the current approach<sup>127</sup> and it is expected that the convention principle will be rejected when the Supreme Court of Appeal has to decide the matter.<sup>128</sup> This court has even suggested a possible way forward which is broadly reconcilable with the conclusions of this study. In *Thoroughbred Breeders' Association v Price*

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<sup>120</sup> UNIDROIT “Official Comments on the UPICC” (2010) *UNILEX* <<http://unilex.info/dynasite.cfm?dssid=2377&dsmid=13637>> (accessed 15-01-2016).

<sup>121</sup> See ch 6 (6 3 3)

<sup>122</sup> C Liu *Remedies in International Sales – Perspectives from the CISG, UNIDROIT Principles and PECL* (2007) 461.

<sup>123</sup> Gotanda “Article 74” in *The UN Convention on the International Sale of Goods* 765.

<sup>124</sup> Saidov *Damages in International Sales* 105.

<sup>125</sup> Article 8 CISG.

<sup>126</sup> Article 9 CISG.

<sup>127</sup> *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 (SCA) 554F; *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 3 SA 670 (A) 688A; *Thoroughbred Breeders' Association v Price Waterhouse* 2001 4 SA 551 (SCA) 581J and 582D.

<sup>128</sup> RH Christie *The Law of Contract in South Africa* 6 ed (2011) 577, with reference made to *Shatz Investments (Pty) Ltd v Kalovyrrnas* 1976 2 SA 545 SA 554E.



*Waterhouse*<sup>129</sup> Nienaber JA stated *obiter* that consideration should be given to the possible adoption of a flexible or supple approach to remoteness in contract law. In particular, he referred to the flexible test for legal causation that has been applied in criminal law and the law of delict.<sup>130</sup> Quoting Corbett CJ, Nienaber JA described this test as

“a flexible one in which factors such as reasonably foreseeability, directness, the absence or presence of a *novus actus interveniens*, legal policy, reasonability, fairness and justice all play their part.”<sup>131</sup>

He suggested that the experience that had been obtained in this regard in criminal law and the law of delict might be fruitfully applied to the law of contract.<sup>132</sup>

Nienaber JA describes the suggested approach as follows:

“[T]he competence of parties to regulate, limit or expand by arrangement amongst themselves the consequences of any prospective breach ... must of course be accommodated in any flexible test ... Both limbs of the current conventional test can readily be blended and integrated as being relevant factors to be taken into account. The fact that both parties had particular consequences in mind when they concluded the contract will still be conclusive. There are many instances where the time of breach will be more appropriate than the time of contract. The circumstances of each case will determine where the emphasis belongs. Reasonable foreseeability, one imagines, will govern most but not all cases.”<sup>133</sup>

It seems clear that our courts are therefore ready to move away from our current approach to remoteness in contract in favour of a more flexible approach. It is suggested that such a flexible approach would necessarily focus on a set of concrete considerations that could be used to determine what a defendant could have taken into account when entering into a contract. This is because the underlying premise of the foreseeability approach is to hold a defendant liable for only those consequences that he could have, had he been reasonable, bargained for at contract conclusion. It is therefore suggested that the time of contract conclusion will always be relevant. The

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<sup>129</sup> 2001 4 SA 551 (SCA).

<sup>130</sup> 582F.

<sup>131</sup> 582H.

<sup>132</sup> 582I.

<sup>133</sup> 583A-583C.

following section will make a few general observations on which considerations should be taken into account in such a flexible foreseeability inquiry.

### *7 3 6 2 Factors to be considered in a flexible foreseeability enquiry*

One factor that is often considered by courts when deciding on remoteness in contract under the model instruments is a defendant's experience and commercial expertise.<sup>134</sup> Where a defendant is a trader in a particular market, for example, courts tend to assume that the defendant has knowledge of prevailing prices or tendencies towards price volatility in that market.<sup>135</sup>

In addition to commercial expertise, a defendant's knowledge of a particular product or industry is also taken into consideration. Where a party knows a particular product well, he is assumed to have been able to foresee losses arising from defects specific to that product.<sup>136</sup>

The particular relationship between the contracting parties, as well as previous dealings between them, have also been considered when determining what parties could reasonably have foreseen.<sup>137</sup> Another important consideration is the scope and purpose of a contract. This consideration has been encountered in the context of the adequate cause theory as supplemented by the *Schutzzwecklehre* in Germany, as well as the assumption of responsibility test in English law. This is also acknowledged and has been applied in the context of the model instruments:

"Normative considerations such as the allocation of risks according to the contract, the purpose of the contract, and the protection intended to be offered by particular contractual obligations should also be taken into account."<sup>138</sup>

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<sup>134</sup> V Knapp "Section II – Damages, Article 74" in CM Bianca, MJ Bonell *Commentary on the International Sales Law – The 1980 Vienna Sales Convention* (1987) 542.

<sup>135</sup> Case No 10 Ob 518/95 (6 February 1996) Austrian Supreme Court <<http://cisgw3.law.pace.edu/cases/960206a3.html>> (accessed 18-04-2016).

<sup>136</sup> Case 00 Civ. 5189 (RCC) (12 August 2006) U.S District Court, Southern District of New York <<http://cisgw3.law.pace.edu/cases/060823u1.html>> (accessed 25-03-2016).

<sup>137</sup> Case VIII ZR 210/78 (24 October 1979) 1979 Bundesgerichtshof CISG <<http://cisgw3.law.pace.edu/cases/791024g1.html>> (accessed 29-01-2016).

<sup>138</sup> I Schwenzer "Section II – Damages: Article 74" in I Schwenzer (ed) *Schlechtriem & Schwenzer Commentary on the UN Convention on the International Sale of Goods (CISG)* 3 ed 999 1020.

Often, the scope and purpose of a contract would be an indication of what a defendant took into account when bargaining for a contract. In such cases, “it is a matter of interpreting the contract and of determining the nature of the interest which the contractual duty that was infringed was designed to protect”.<sup>139</sup>

This is a valuable consideration to take into account where such interests, scope or purpose of a contract is actually discernible. But, as we have seen in the context of German law, that it is not always the case.<sup>140</sup> Where there is no defined scope, a test would have to rely on other factors to determine the foreseeability of losses.

Another factor to consider could also be the commercial context of a contract. In other words, the court has “to understand not only circumstances of any immediate dispute but also the larger business and institutional context in which the contract was formed”.<sup>141</sup>

In this regard, consideration of trade usages in an industry could provide guidance. In the discussion of the model instruments, we have seen how the CISG makes explicit mention of the fact that trade usage should be considered when determining reasonable foreseeability.<sup>142</sup> It has been held that the foreseeability requirement “can conclusively be met by showing a trade custom”.<sup>143</sup> This is also in line with the underlying rationale of the foreseeability theory – if a well-defined custom exists in a certain industry, parties to a contract will know or ought to know of the custom’s implications for the risk of liability that they are assuming in the contract. It will be reasonable to expect of parties to enter into contracts with those customs and the risks that they imply in mind.

These are only some of the possible factors that could form part of a flexible approach to remoteness in contract. Arguably, courts would have to determine foreseeability on

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<sup>139</sup> Zimmermann 2014 *Edin. L. R.* 206.

<sup>140</sup> Markesinis *Introduction to the German Law of Torts* 102

<sup>141</sup> RA Epstein “Beyond Foreseeability: Consequential Damages in the Law of Contract” in RG Frey & CW Morris (eds) *Liability and Responsibility – Essays in Law and Morals* (1991) 89 90.

<sup>142</sup> 8 CISG.

<sup>143</sup> EC Schneider “Case VIII ZR 210/78 (24 October 1929) Digest” (1979) *CISG* <<http://cisgw3.law.pace.edu/cases/791024g1.html>> (accessed 29-01-2016).

the facts of a particular case, and often those facts will indicate which considerations should be decisive.

## **7 4 Conclusion**

Over the course of the discussion of various theories of remoteness in contractual damages, this study has identified the common underlying principle that the limits of contractual damages should be determined with reference to what the party in breach could reasonably have taken into account when concluding a particular contract.

We have seen that this idea is the underlying justification for the foreseeability theory. The idea also informed much of the criticism and ultimately the rejection of the direct consequences theory, and contributed to the development of the adequate cause theory. The principle that the party in breach should be liable for all losses that he reasonably could have contemplated when concluding a contract seems, therefore, like the appropriate point of departure for an inquiry into remoteness of contractual damages.

The research suggests that the foreseeability theory is most suited to identify what could have been considered when contracting. Given the fact that it is in line with notions of fairness or equity and the constitutional value of human dignity and that the underlying rationale of the foreseeability theory – as well as the theory itself – has formed part of South African case law, it can be regarded as the most appropriate approach to remoteness of contractual damages in our law.

This study has, however, also highlighted a number of limitations of the foreseeability theory as it is currently applied. In this regard, lessons can be drawn as to the desired future course of development of the foreseeability theory in our law.

Firstly, it seems that a distinction between general and special damages does not add to the foreseeability test, but rather obscures the inquiry into what could have been considered when contracting. The study suggests that abandoning the distinction between types of damages could be beneficial. It removes an artificial distinction between two separate tests for recoverability of losses when in truth the underlying principle should be identical for all damages.

Secondly, the study suggests that a focus on the intentions of parties with regard to liability upon contract conclusion should not form part of a test for the recoverability of damage. Requiring agreement about the recoverability of damages would often amount to the imposition of a fiction. Where parties did have shared intentions with regards to liability for damages that should of course be enforced. However, a determination of remoteness should not require a determination of contractual intentions where often there were none.

The third conclusion that can be drawn from the study is that it is not always possible to draw a strict distinction between the nature and the extent of losses. Additionally, requiring only the nature of damage to have been foreseeable at contract conclusion will often lead to inequitable results. A further suggestion is that it might be a welcome simplification to focus a foreseeability inquiry only on what the defendant could have reasonably foreseen, and not to take into account the perspective of both parties. The study also suggests that it is often unnecessary and unhelpful to fixate on an appropriately defined level of probability with which damage ought to have been foreseeable.

Finally, the study suggests that the foreseeability theory should be applied in a flexible manner with reference to the facts of a particular case. The core question to be asked is simply whether a defendant reasonably could have taken the particular damage into account, or actually did foresee the damage, when he was concluding the contract. Such a question cannot be answered with reference to a strictly defined test which does not take into account the circumstances of the case. Rather, a variety of factors could contribute to the answer. These include the particular knowledge and expertise of the defendant; previous dealings between the parties; the commercial context and trade usages pertaining to the contract; the scope and purpose of the contract in question, as well as its underlying risk allocation.

A test of foreseeability which allows for the flexible application of these and other considerations alleviates many of the problems and limitations of the traditional foreseeability test. It also grounds the remoteness inquiry in real-life, concrete considerations that might provide more guidance than the traditional test for foreseeability. As *Thoroughbred Breeders* indicates, there are promising signs that

South African courts may be in favour of adopting such a flexible approach in the future.

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## Index of Legislation

### South Africa

The Constitution of the Republic of South Africa, 1996

## **United States of America**

Uniform Sales Law, 1906

## **Index of Cases**

### **Austria**

*Case No 10 Ob 518/95* (6 February 1996) Austrian Supreme Court *C/SG*  
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RGZ 81, 359

RGZ 42, 291

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BGHZ 3, 261

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BGHZ 27, 37

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